Future Cities

# Office Sustainability Overview

REPORT

SYDNEY CBD

CBRE RESEARCH
SEPTEMBER 2024

# Is Sydney ready to shift?

This report will examine how the shift towards more sustainable environmental practices will impact the Sydney CBD office landscape specifically. It will look at how occupiers are thinking about sustainability considerations, the actual demand for ESG credentialed space, and which types of occupiers are leading the charge. It will also assess the readiness of the Sydney CBD office market for a more widespread shift towards sustainable office requirements.

## What is ESG?

Over the last 25 years, the global economy has made significant efforts to incorporate morally conscious business practices into their operations. These broad efforts have been grouped under the catch-all term 'ESG', which represents a set of Environmental, Social, and Governance factors which impact business strategies and decisions. ESG considerations have become a key component in how businesses across all industries both run their day-to-day operations and set their higher-level corporate strategies.

While each of the three pillars of ESG have implications for the commercial real estate sector, a large focus over recent years has been on the environmental component. The commercial real estate sector has an outsized impact on the environment and is one of the largest contributors to global energy related carbon emissions and climate change.

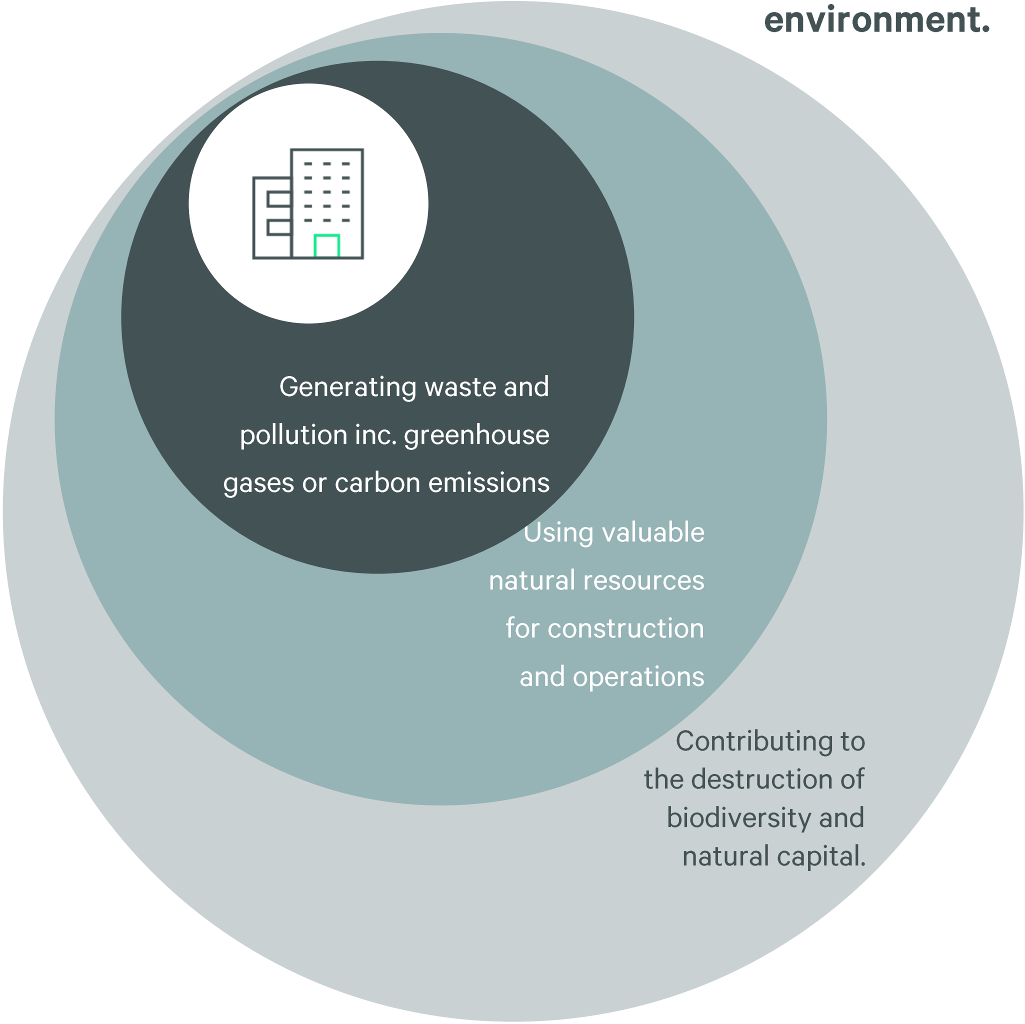
## How does it relate to Commercial Property?

It has been extremely important for both owners and users of commercial properties to begin considering how they can minimize their impact on the environment and ensure their operations are as climate conscious and sustainable as possible.

Government and regulatory bodies around the world have made significant strides to develop and adopt strong commitments to climate policies and regulations, and the corporate sector has followed suit.

The majority of government and corporate environmental policy is now aimed at achieving Net Zero carbon emissions before 2050 as outlined in the Paris Agreement. More progressive corporations have even set more aggressive Net Zero targets, hoping to achieve these benchmarks between 2025 and 2030. Given that changes to business operations take years and/or decades to implement, firms are starting to act now so that they have a viable roadmap to reach their goals within the appropriate timelines.

**These are some ways in which the property sector impacts the environment.**



# What are occupiers saying?

The primary theme driving office leasing activity over the last two years has been a “Flight-to-Quality” by occupiers. While this trend is typically thought to relate to building grade and geography, the sustainability credentials of a property are also a significant component of its quality.

CBRE’s APAC Office Occupier Survey reports, *there is clear evidence that occupiers are increasingly focused on finding accommodations in highly credentialed ESG properties to meet corporate sustainability targets and future-proof their office accommodations.* When asked which building features were most sought after when considering new space, 71% of respondents indicated they preferred properties with good access to public transportation, 48% indicated they preferred building which boasted sustainable building features and operations, and 24% indicated that they wanted access to electric vehicle charging stations.

It was also found that 64% of the occupiers surveyed indicated that they had a desire to expand the share of their footprint in ESG-certified buildings over the next three years.

**These findings clearly show that having strong sustainability credentials is becoming a major requirement for occupiers.**

APAC Office Occupier Survey Results

**Most sought after building features**

71%

Public transport access

48%

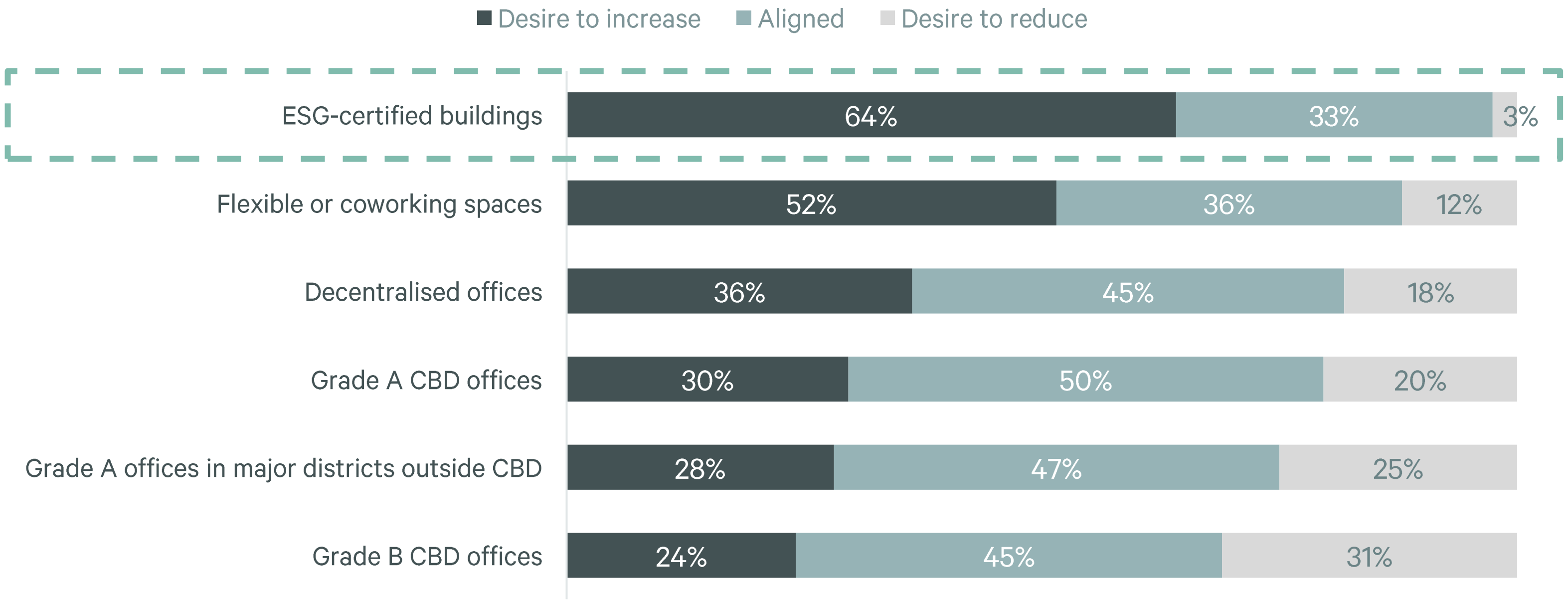
Sustainable building features and operations

24%

Electric vehicle charging stations

APAC Office Occupier Survey Results

**Alignment between current office locations and desired locations over the next three years**




Sources: CBRE Research, 2023

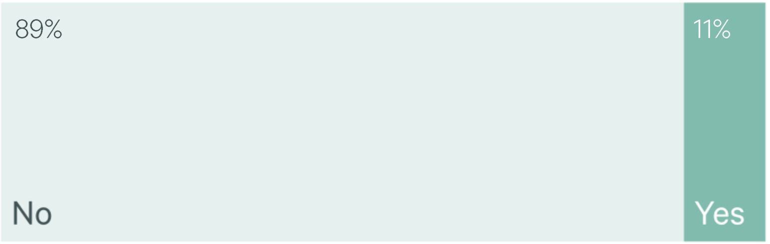
# What is the current demand for ESG credentialed office space?

While occupiers are clearly thinking about the ESG credentials of their office accommodations and indicating that moving into ESG certified space will be a focus for them going forward, demand for such space has remained somewhat mixed as of mid-year 2024. *Based on tenant enquiries for office space in the Sydney CBD from 2023 to H1 2024, only 11% of leasing enquiries tracked by CBRE made note of ESG criteria in their briefs to the market.*

One of the primary reasons for this disconnect between the stated intentions of occupiers and actual demand, is that many occupiers are still hesitant to pay the cost premiums associated with ESG certified space. Based on data from the APAC Occupier Survey, 82% of occupiers indicated that they'd prefer moving into a green buildings. However, only 23% of respondents indicated that they'd be willing to pay a premium for such space.

This suggests that despite ESG growing in importance in the decision-making process, it's not the primary driver of leasing decisions currently.

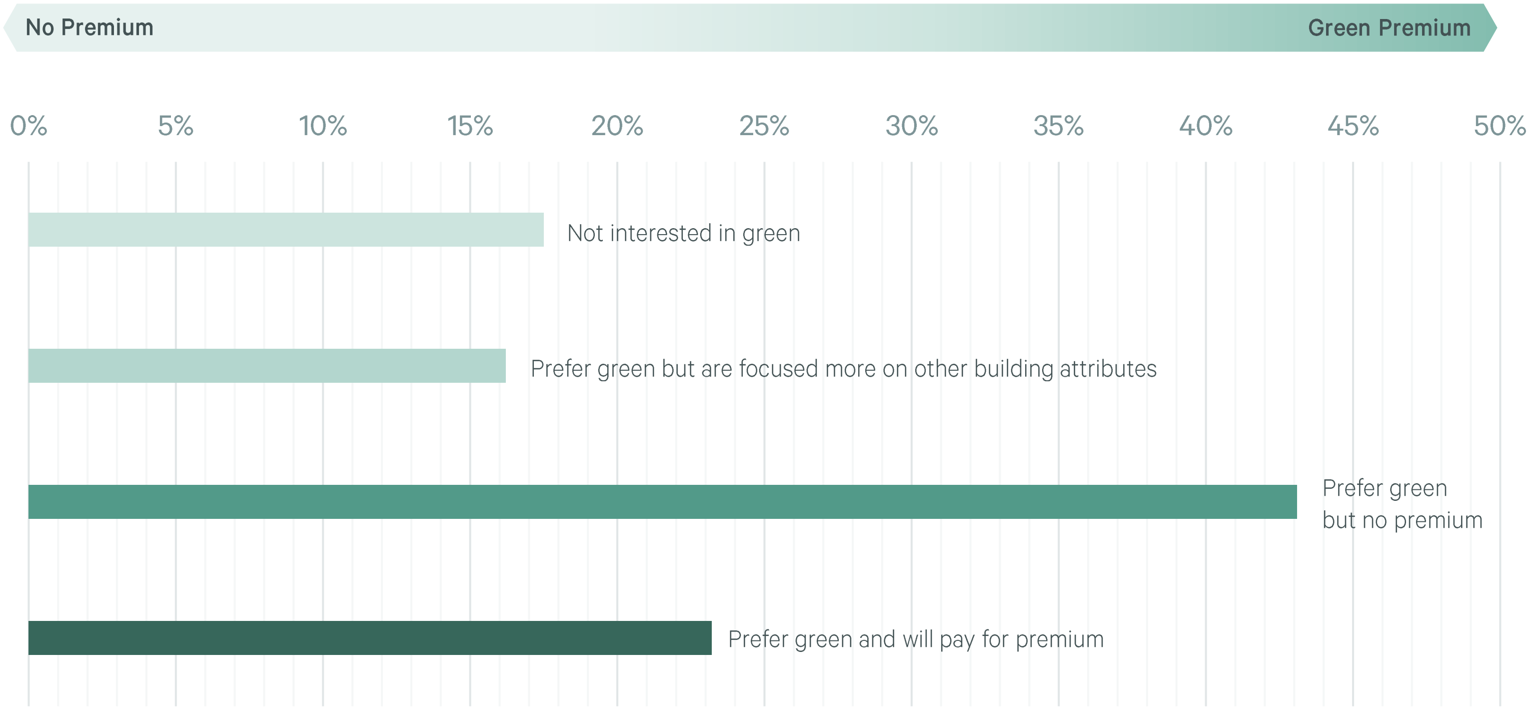
FIGURE 1: Share of Sydney CBD office leasing enquiries which mention ESG criteria ('23 to H1 '24**) by number of briefs**




Source: CBRE Research, June 2024.

APAC Office Occupier Survey Results

**Willingness to pay a premium for ESG-certified office buildings**




64 Enquiries

No. of enquiries which mentioned ESG credentials in leasing brief *2023 to H1 2024*

# Who is driving ESG demand?

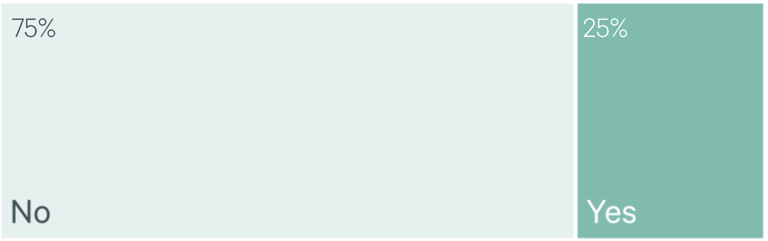
## Which types of occupiers are driving ESG demand?

While demand for sustainable space appears muted based on the number of enquiries received over the last 18 months, demand is far more substantial when analysing the data based on the size of briefs. The share of briefs which mention sustainability criteria increased to 25% when looking at the data based on the volume of requirements. This 25% equates to demand for roughly 160,000 sqm of highly credentialed ESG space within the Sydney CBD. It's also important to note that this analysis only tracked mentions of ESG in initial briefs or formal follow-up conversations. In reality, demand for such space is likely far greater than this figure.

When looking at enquiry data, it becomes *clear that larger occupiers are the ones driving the bulk of demand for ESG credentialed space*. Over 50% of the enquiries in the +5,000 sqm size bracket mentioned ESG criteria in their brief to market. This compared to only 6% of briefs in the sub-1,000 sqm size bracket.

Given the outsized impacts larger firms have on the environment, these companies have been first to adopt defined corporate ESG policies, goals, and targets. While it's expected that larger corporations will continue to lead the push towards better ESG space, smaller firms will need to follow suit as societal and regulatory pressures mount.

FIGURE 2: Share of Sydney CBD office leasing enquiries which mention ESG criteria ('23 to '24-H1) **by volume of briefs**

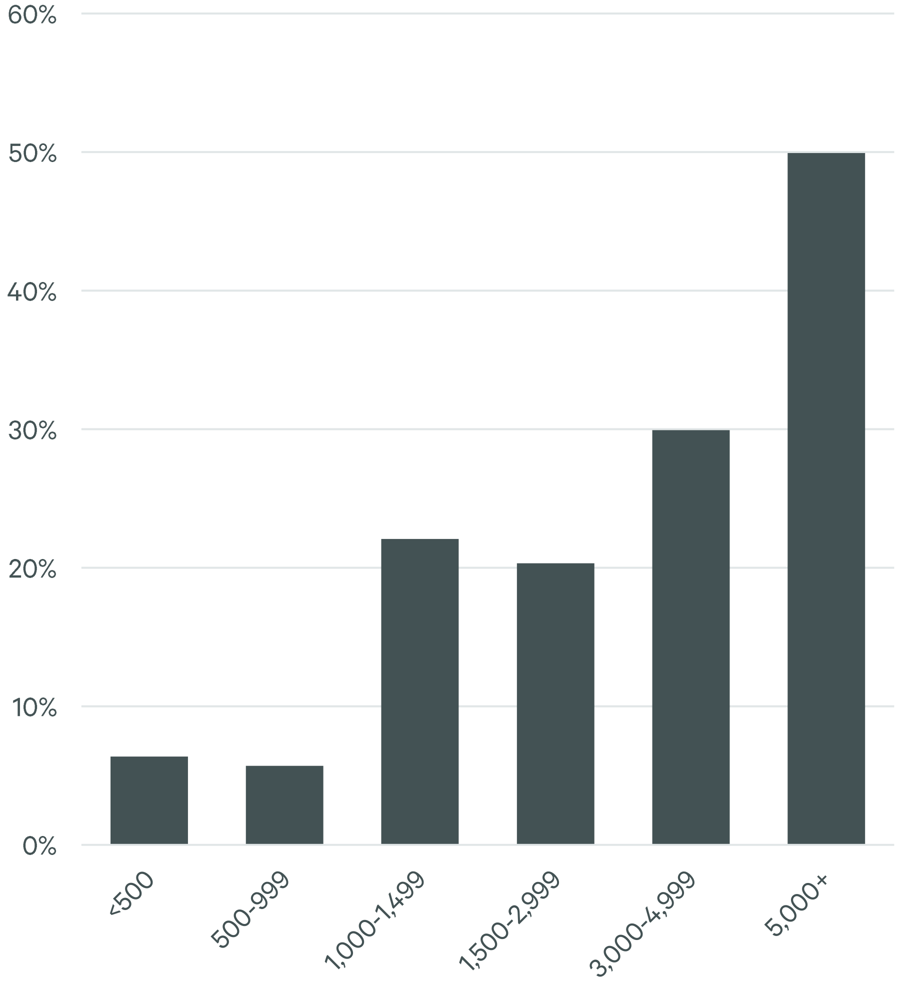



Source: CBRE Research, June 2024.

160k sqm

Volume of enquiries which mentioned ESG credentials in leasing brief
*2023 to H1 2024*

FIGURE 3: Share of leasing enquiries which mention ESG by size
**Share of Briefs (volume)**




Source: CBRE Research, June 2024.

## Which industries are driving ESG demand?

Demand for highly sustainable space has been well spread across a variety of industries over the last 18 months.

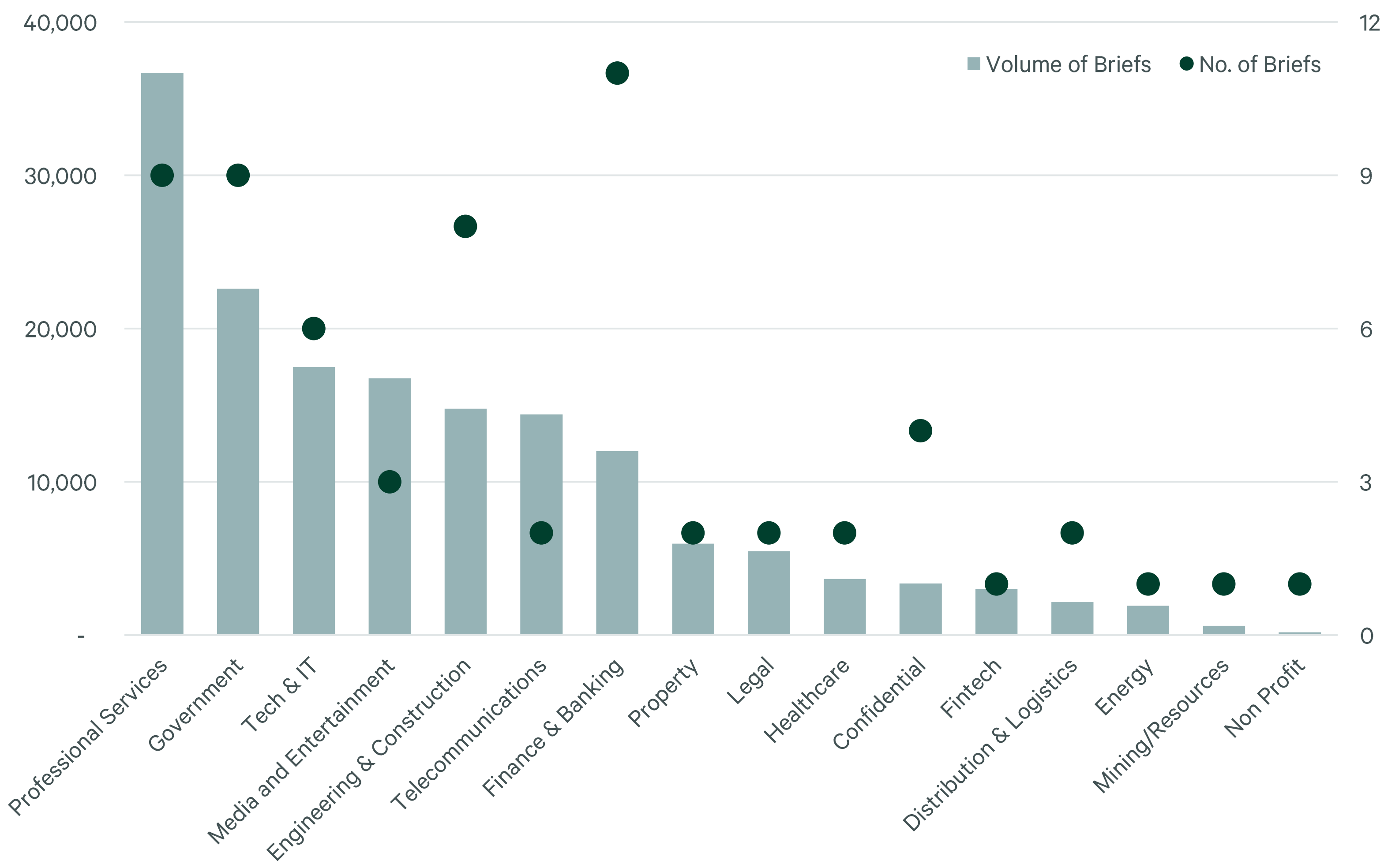
The greatest demand, however, has expectantly come from higher profile white collar industries including Professional Services, Tech & IT, Media & Entertainment, Engineering & Construction, Telecommunications, and Finance & Banking.

Given the media attention afforded to these firms, their diverse workforces, and their global presences, they have had the greatest impetus to adopt sustainability targets over the last few years. Many of these firms operating in Australia are also multinational corporations with ESG mandates being driven by more advanced regulatory environments in other global markets.

Outside of the private sector, Australian government agencies have also taken firm stances on the ESG criteria of their office space. Public groups have shown a strong preference to lease space in highly credentialed ESG properties over recent years. These preferences are now becoming formal policy.

*Given the breadth of demand for sustainable space across industries, office owners will need to ensure that their buildings are offering as many ESG related amenities as possible and that they spend the capital required to obtain strong ESG credentials for their properties.* While this is a key concern for higher grade assets at this time, it will become increasing important for Secondary assets as well as smaller occupiers become more sophisticated in terms of their approaches to sustainability.

FIGURE 4: Share of leasing enquiries which mention ESG by industry




Source: CBRE Research, June 2024.

## Case Study

# Impact of public sector occupiers in Government focused markets

Government agencies have adopted some of the more aggressive ESG initiatives of any office occupier type in Australia. The Commonwealth Government has set a goal of achieving Net Zero greenhouse gas emissions from its operations by 2030 and their real estate decisions will play a significant role in their ability to reach this target.

As part of this initiative, the Commonwealth has stated that it will have a strong preference towards all electric office buildings starting in 2024. By 2025, they will require that any new leases larger than 1,000 sqm be in buildings with a minimum NABERS energy rating of 5.5 stars. By 2026, government leases will only be signed in all electric buildings, with minimum NABERS energy ratings of 6 stars, and Green Star ratings of 4 stars.

**These requirements will be of extreme importance in markets like Canberra, where government agencies are the largest user group by a substantial margin. As per CBRE's database of office leasing enquiries received in Canberra since 2023, 65% were from public sector users.**

This case study shows how rapidly requirements from specific user groups may shift going forward. It also underlines how owners need to proactively prepare for this shift to future proof assets and ensure that the markets in which they operate are able to satisfy demand for ESG credentialed space.

FIGURE 5: Share of Canberra office leasing enquiries by Industry ('23 to '24-H1) **by volume of briefs (sqm)**


164k sqm

Volume of office leasing enquiries from public sector occupiers
*2023 to H1 2024*

FIGURE 6: Commonwealth Government ESG Timeline for Office Leasing

| **Date** | **Leases Signed in Existing Buildings** | **Leases Signed in New Developments** |
|---|---|---|
| Jul 2024 | Preference **All Electric Buildings**<br>**EV Charging Plans** | Preference **All Electric Buildings**<br>**EV Charging Plans** |
| Jan 2025 | **EV Charging Facilities** | **EV Charging Facilities** |
| Jul 2025 | **+5.5 Star NABERS Energy**<br>*Leases >1,000 sqm* | **+5.5 Star NABERS Energy**<br>*Leases >1,000 sqm* |
| Jul 2026 | | **All Electric Buildings**<br>**6 Star NABERS Energy**<br>**4 Star Green Star Buildings** |
| Jan 2040 | **All Electric Buildings**<br>*No excluded scopes* | **All Electric Buildings**<br>*No excluded scopes* |

Source: CBRE Research, Commonwealth Government, June 2024.

# Evolving Environmental Standards

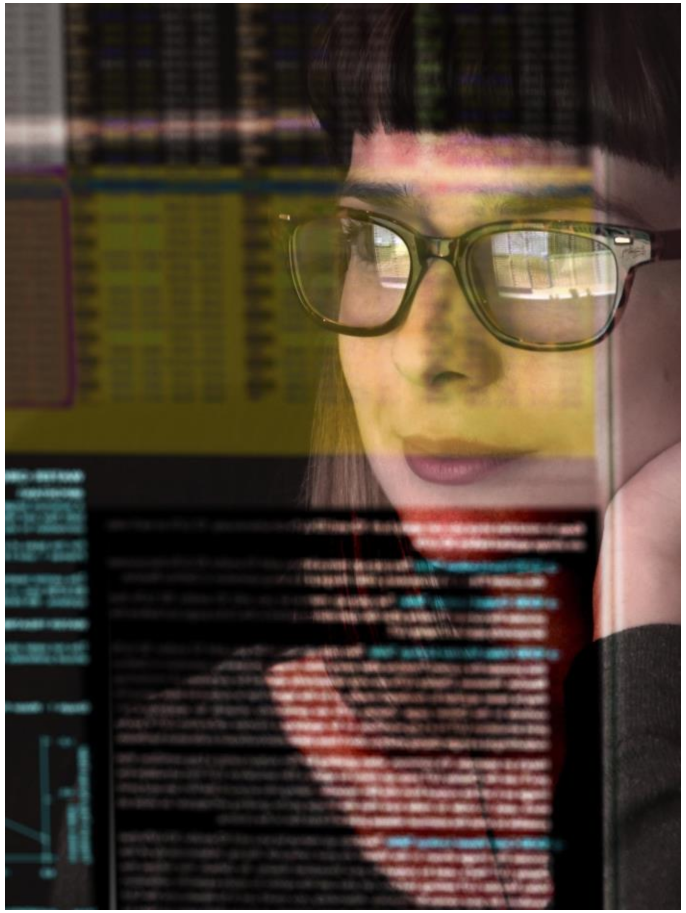
## How is the environmental performance of properties being assessed?

In Australia, NABERS ratings have become the industry standard for environmental certification of commercial properties. These ratings provide a quick way for users to gauge the efficiency of a building and are a great starting point for measuring a buildings performance across individual areas of operation such as energy, water, waste, and indoor environment. While a buildings performance can be rated across each of these areas, the most common rating is NABERS energy.

A NABERS energy rating of 5.0 stars is considered 'very good', and this is the rating that most users appear to be targeting currently. While this is the case as of today, it is important to note that environmental standards are shifting rapidly and what is considered excellent today, may not be in the future. NABERS ratings are renewed on rolling 12-month cycles and it's therefore imperative that owners maintain the operational performance of their properties to remain competitive.

It's also important to note that the ESG credentials of a property are not wholly defined by their NABERS ratings. Occupiers are increasingly considering additional ratings systems such as Green Star, the availability of EV charging stations, proximity to public transit, and future roadmaps to additional sustainability improvements in their leasing decisions.

It's also now becoming clear that the next benchmark for the environmental performance of office properties will be the elimination of gas as an energy source. To achieve true Net Zero status, properties will need to be fully electric and have no dependence on non-renewable gas or diesel for their operations.



## What is a Green Lease?

The term "Green Lease" has become a catch-all term for any lease clauses which relate to sustainability. These clauses currently cover a variety of topics which relate to the management and operation of a property, including:

- The maintenance of a property's existing ESG ratings, credentials, or certifications
- Any commitments made by owners as it relates to the waste management systems used by a property
- Any benchmarks on the roadmap to Net Zero and/or full-electrification of a property
- Access to and sharing of sustainability data between occupiers and owners

While Green Leases currently vary widely depending on the sophistication of the owner or occupier in question, these clauses are becoming common practice and will continue to be seen going forward.

# How prepared is the Sydney CBD to go sustainable?
## The Strengths

**Prime Office Market**

Given the size of the Sydney CBD office market and its position as the financial capital of Australia, the existing Prime office stock in Sydney is well rated from a NABERS energy perspective.

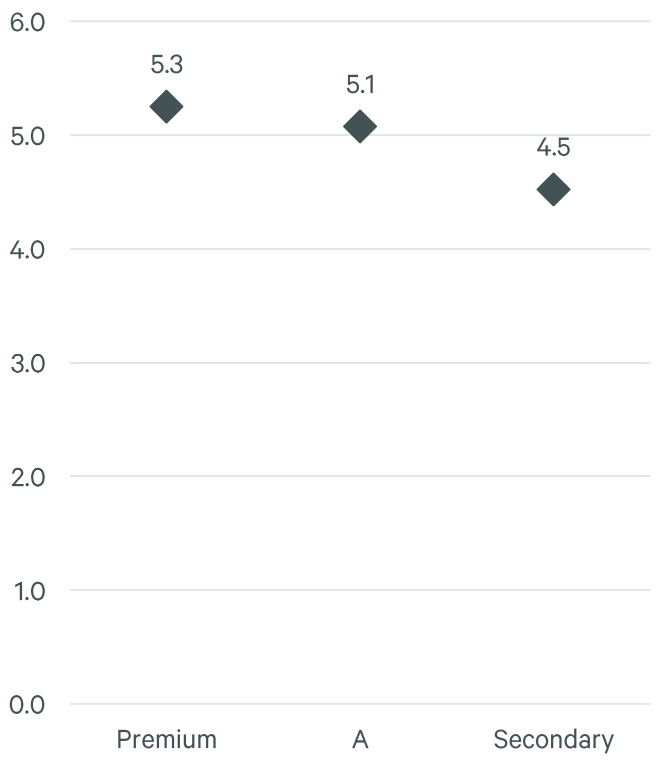
*The average NABERS energy rating for a Premium office asset in the Sydney CBD was 5.3 stars as of June 2024. This figure only decreased marginally when looking at A Grade assets, which had an average NABERS energy rating of 5.1 stars.*

Additionally, the shares of Premium and A Grade office properties in the Sydney CBD with NABERS energy ratings above 5.0 stars were 95% and 77%, respectively, as of June 2024.

At a high level, these findings show that the Prime office market in the Sydney CBD is well aligned with the current demand from occupiers. Based on the leasing enquiry data collected by CBRE, 55% of prospective occupiers which explicitly mentioned NABERS ratings in their briefs to market, referenced a preference for buildings with NABERS energy ratings of 5.0 stars or above.

This means that those occupiers could hypothetically move to nearly any Premium property in the Sydney CBD or over three quarters of all A Grade properties.

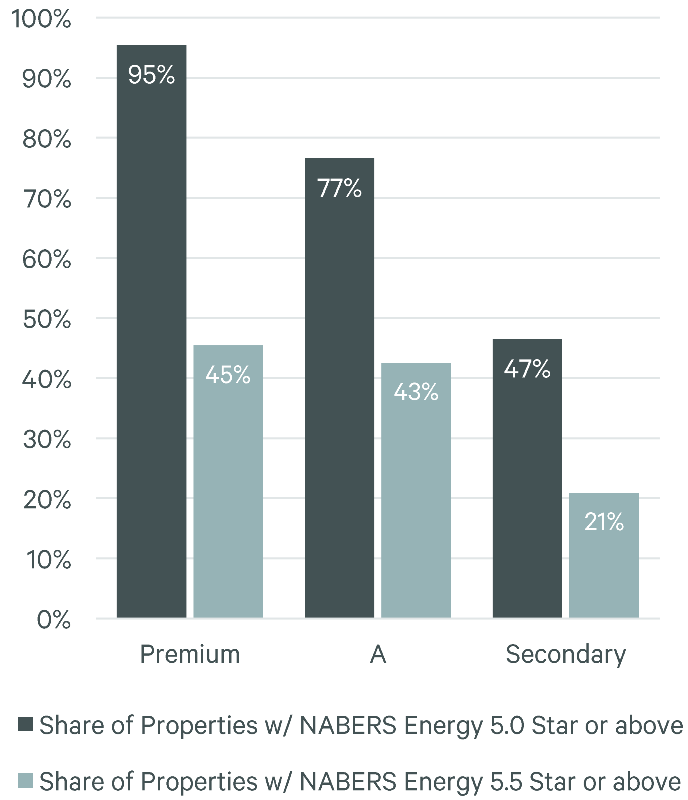
FIGURE 7: Average NABERS Energy rating in existing Sydney CBD Prime & Secondary office stock




*Note: Analysis includes properties >10,000sqm only.*

Source: CBRE Research, June 2024.

FIGURE 8: Share of properties w/ NABERS energy ratings above +5.0 & +5.5 stars in Sydney CBD stock



# How prepared is the Sydney CBD to go sustainable?
## The Challenges

### Secondary Office Market

While the Prime office stock in the Sydney CBD is relatively well prepared for ESG demand, this isn't to say that the Sydney CBD office market has no gaps from a sustainability perspective.

*The average NABERS energy rating for Secondary office properties in the Sydney CBD was only 4.5 stars as of June 2024.*

Additionally, only 47% of Secondary office properties had NABERS energy ratings of 5.0 stars or above.

As demand grows from smaller office occupiers or those groups that are less willing to pay Prime rental rates, leasing options will become much more limited.

Because Secondary office properties are often older than their Prime peers, they are also often harder to upgrade to better sustainability performance levels. The Sydney CBD will therefore face significant challenges providing strong ESG credentials in the Secondary segment of the market going forward.

### Availability of office properties with +5.0 star NABERS ratings

An additional concern is that if ESG standards continue to accelerate, the Sydney CBD may be less prepared than it appears to be currently. *Should the standard for an excellent NABERS energy rating increase from 5.0 to 5.5 stars, for example, the share of Premium, A Grade, and Secondary properties which would be able to satisfy these demands decrease to only 45%, 43%, and 21%, respectively.*

The industry is already shifting towards targeting NABERS energy ratings of 5.5 stars and above. While a NABERS energy rating of 5.0 stars used to be considered "excellent" it would now only be considered "very good". The speed at which these standards are shifting means that owners of office properties in the Sydney CBD need to begin acting now to remain competitive going forward.

### Emergence of additional ESG certifications

There is also growing demand for space in properties with additional sustainability credentials outside of the NABERS rating system. The most common such rating system at this time is Green Star, which measures a buildings performance across a more holistic set of criteria than NABERS. Green Star ratings are becoming increasingly important, and *56% of existing Sydney CBD office properties had received Design, As Built, or Performance based Green Star ratings as of 2023.* Given the growing importance of assessing ESG criteria outside of NABERS, owners who are able to attain certifications such as Green Star can differentiate their properties significantly and expand their potential tenant pool.

**4.5**
Average NABERS star rating

**47%**
Secondary office properties had NABERS of 5.0 or above

Share of properties with NABERS ratings of +5.5 stars

**45%**
Premium

**43%**
A Grade

**21%**
Secondary

**56%**
Existing Sydney CBD office properties had received Green Star ratings

*Note: Analysis includes properties >10,000sqm only.*

Source: CBRE Research, June 2024.

# The shift towards electrification (Net Zero)

The next sustainability frontier for the property industry will be achieving the goal of Net Zero carbon emissions. For the office sector this will mean that all properties must shift away from non-renewable energy sources such as gas, towards electric and renewable energy.

*Unlike with NABERS ratings, the existing office stock in the CBD has a long way to go before eliminating gas as an energy source. As of June 2024, the average office property within the Sydney CBD used gas powered energy for 22% of its operations.*

This ratio also didn't change significantly across building grades, with Premium, A Grade, and Secondary properties using gas energy for an average of 22%, 23%, and 21% of their operations, respectively. The challenge of eliminating gas as a power source will therefore apply across building age and quality.

As of June 2024, only six properties in the Sydney CBD with published energy usage data used 100% electric energy for their operations. This equated to only 3.2% of the exiting office NABERs rated office stock in the Sydney CBD.

When combined with NABERS energy and Green Star ratings, it can be said every office property in the Sydney CBD could improve its sustainability performance. *No asset currently boasts 100% electric energy use, a NABERS energy rating of 5.5 star or greater, and a Green Star rating.* There is therefore considerable work to be done before the sector reaches the goal of Net Zero.

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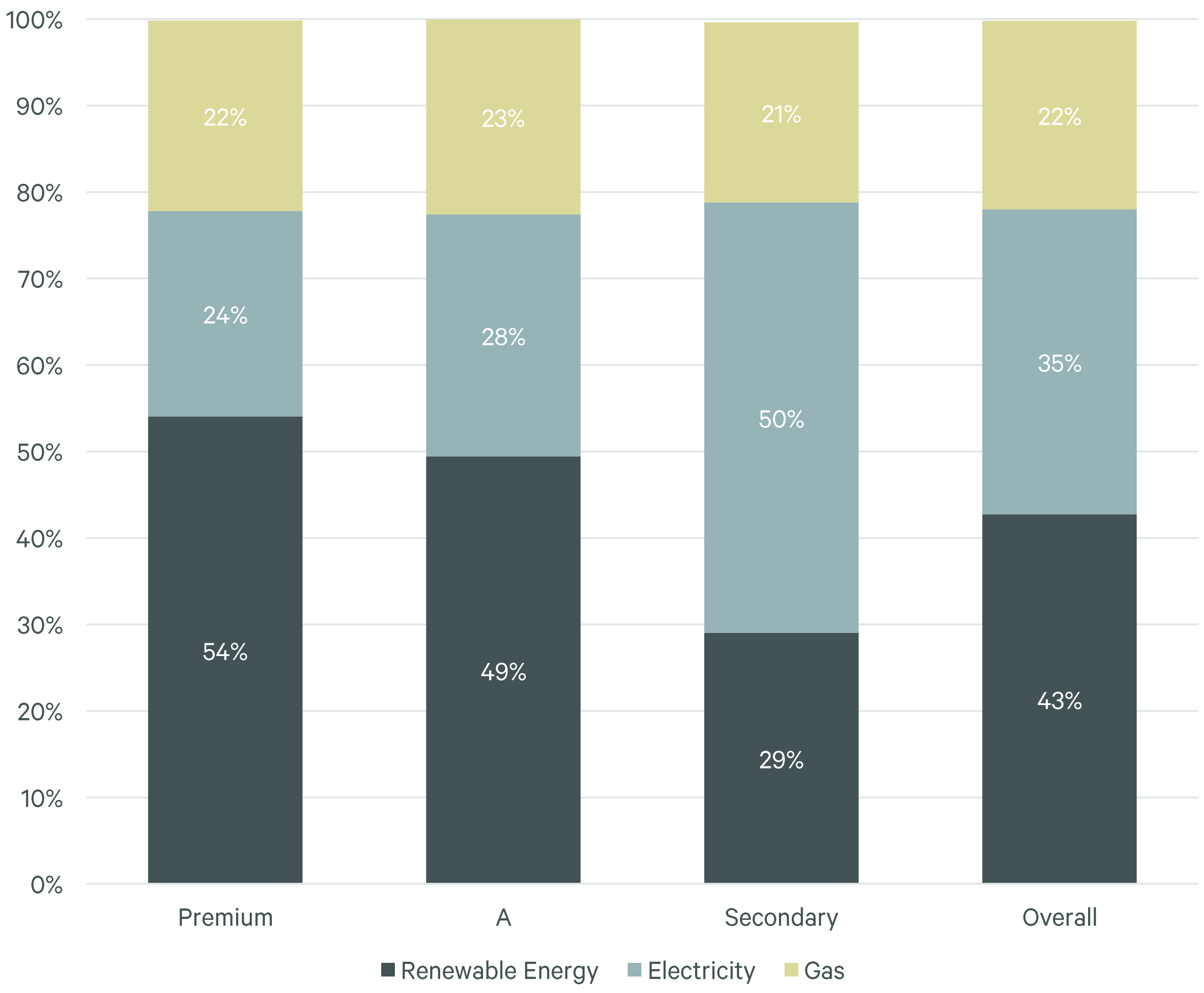
Sydney CBD Office properties are fully electric

3.2%

Sydney CBD office NLA in a fully electrified property

FIGURE 9: Average Office Property Energy Usage by Building Grade




*Note: Analysis includes properties >10,000sqm only.*

Source: CBRE Research, June 2024.

# Key Takeaways

It's clear that commercial property will be heavily impacted by the ongoing shift towards more ESG focused business practices. While efforts have been made to prepare for this change, there is still considerable work to be done by both owners and occupiers to ensure that the space is well prepared and that we as an industry are doing our part for the environment.

As it relates to the office market in the Sydney CBD, there are clear takeaways:

– Occupiers are increasingly thinking about ESG in their day-to-day operations, and this is having material impacts on their leasing decisions.

– While leasing demand for highly credentialed ESG space appears moderate at first glance, demand is accelerating.

– The greatest demand for highly credentialed ESG space is coming from larger occupiers. Over 50% of office leasing briefs larger than 5,000 sqm made mention of ESG requirements.

– Leasing demand is coming from occupiers across a broad spectrum of industries.

– While the Prime end of the Sydney CBD office market appears well suited to meet the growing demand for ESG credentialed space, Secondary properties are less prepared.

– The next frontier for the property sector will be achieving Net Zero emissions targets. This won't be possible without eliminating the use of gas energy and shifting towards refrigerants with much lower global warming potential. The Sydney CBD still has a long way to go in this regard as only 3.2% of the rated office stock in the Sydney CBD is currently fully electric.

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