Commercial Research

Between the Lines

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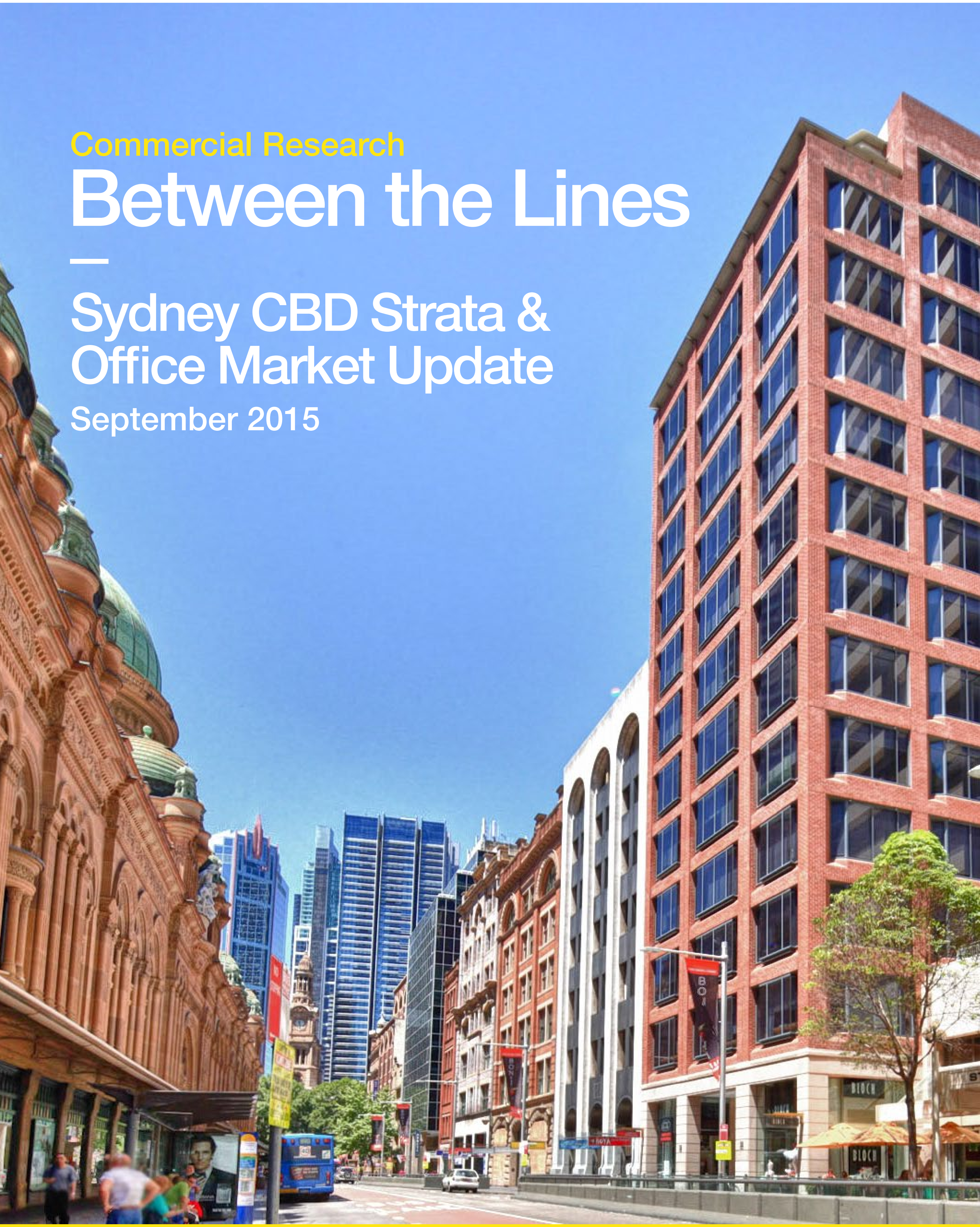
Sydney CBD Strata & Office Market Update

September 2015



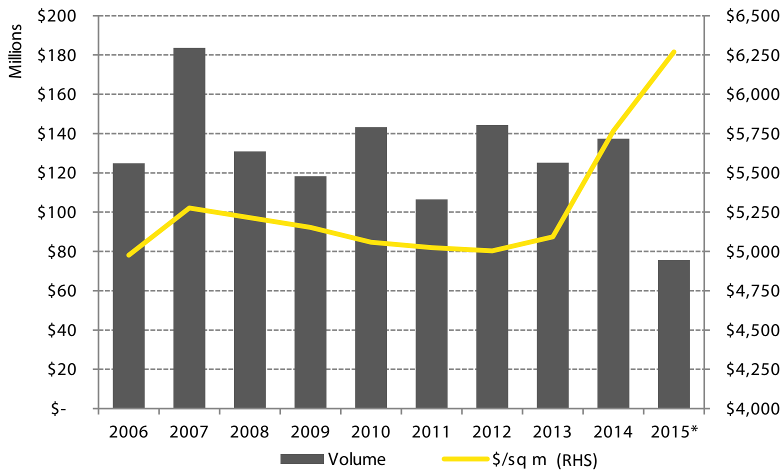
2015 has been a standout year for the Sydney CBD office market so far. Vacancy levels are currently the lowest CBD rate in the country at just 6.3%, which has spurred on some face and effective rental growth after a prolonged stable period.

Investment activity has been a strong theme for the year with investment levels in prime assets at a high driving the yield down to lows unseen since pre GFC as the weight of funds compete for assets.

The strata market has seen outstanding results in capital values growing strongly for the second consecutive year to now average $6,200/sqm.

Sydney CBD Strata

Volumes v Capital Values



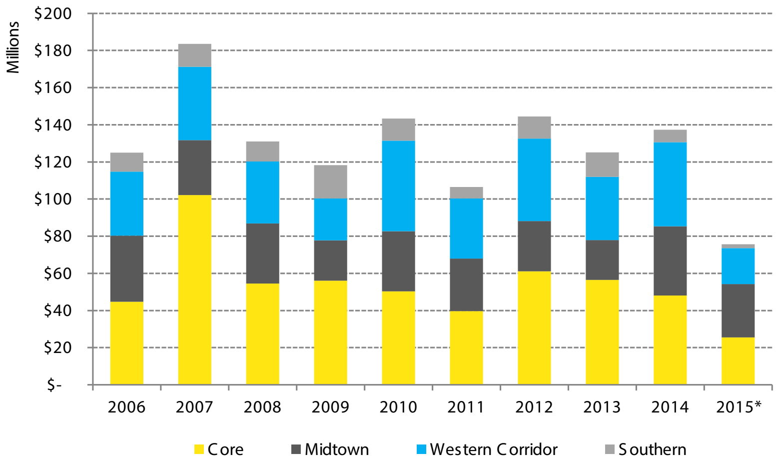
Source: Ray White, Cityscope (* to 1 August)

Interest in the Sydney office market has not just been restricted to the high end freehold market with investment interest in the strata office market strong over the past 18 months. Total volume of investment was strong during 2014 however a lack of available supply to the market was instrumental in growing the average investment rate to $5,767/sqm. 2015 has set a new benchmark rate after a strong start to 2015 with over $75 million changing hands across 96 transactions increasing the average capital value by 7.48% to $6,200/sqm. This increase has been driven by a strong 6.89% increase in the active Core precinct however the largest increase has come from the Southern precinct albeit off a historic low rate achieved last year given the limited investment pool.

Investment levels may not reach the highs of 2014 however the capital values achieved so far this year are 21.75% more than achieved in 2013. This highlights the quest for assets during this low interest rate period and the range of investors keen to invest in the Sydney CBD Strata market.

Sydney CBD Strata

Sales Volume by Precinct

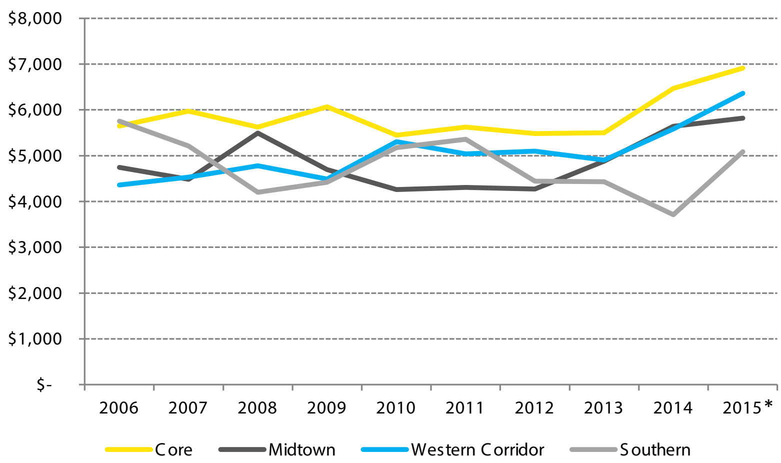


Source: Ray White, Cityscope (*to 1 August)

Investment activity in 2015 has reached $75.07 million in the period to the end of July which represents 11,862 sqm across 96 transactions. The greatest turnover achieved in Midtown with $28.85 million across 34 sales, the average property size being 141sqm, this highlighting the more affordable nature of this region compared to the usually dominant Core. The Core has reduced its investment activity this year with $25.44 million changing hands albeit representing a greater number of transactions at 42 showcasing the smaller suite size, averaging 88sqm. The Western Corridor has historically been an active region with a high level of supply at differing qualities making it an attractive region for both owner occupiers and investors. During 2015 there has been $18.11 million sold across 16 transactions, this represents 2,980sqm of stock bringing the average suite size up to the largest across the CBD at 181sqm. The Southern precinct has very limited strata stock resulting in historically volatile results; this period is no different with only three transactions taking place.

Sydney CBD Strata

Capital Value by Precinct ($/sqm)



Source: Ray White, Cityscope (*to 1 August)

The average capital value has seen good levels of growth over the last 12 months across all precincts of the CBD. The greatest increase has come from the Southern precinct at 37.04% however given the limited investment pool and the low base of 2014 this is in line with the volatile nature of this region. Midtown has the greatest volume of sales yet achieved the lowest rate of growth of 3.20% to $5,821/sqm nearing closer to the high of the Core, this market has seen a healthy 6.89% increase since 2014 to $6,912/sqm. The Western Corridor has a wide range of quality in assets from small Chinatown assets to the King Street Wharf resulting in a broad range of capital values, the volumes of transactions have been high thus far in 2015 resulting in a sizeable 8.83% increase to $6,077/sqm.

Table of Strata Sales

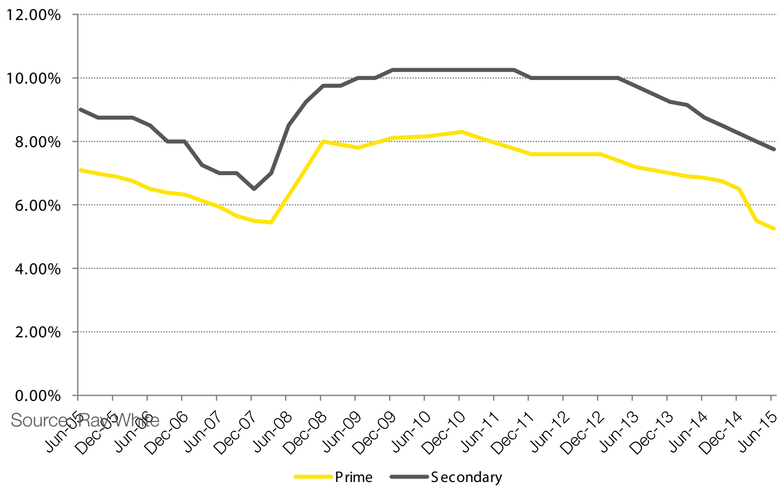
Address	Region	Area (sqm)	Sale Price	Sale Date	$/sqm
Level 6, 261 George Street	Core	339	$2,725,000	Aug-15	$8038
Suite 705, 84 Pitt Street	Core	94	$575,000	Aug-15	$6,117
Suite 31–34, 183 Macquarie Street	Core	75	$680,000	Jul-15	$9,067
Suite 805, 109 Pitt Street	Core	64	$500,000	Jul-15	$7,813
Lot 19, 72 Pitt Street	Core	139	$670,000	Jun-15	$4,820
Level 7, 33 York Street	Western Corridor	529	$4,000,000*	Sep-15	$7,561
Level 10, 33 York Street	Western Corridor	556	$3,450,000	Aug-15	$6,205
Unit 4, 131 Clarence Street	Western Corridor	182	$960,000	Jun-15	$5,275
Units 51–54, 99 York Street	Western Corridor	472	$2,600,000	May-15	$5,508
Suite 401, 276 Pitt Street	Midtown	62	$415,000	Jul-15	$6,694
Suite 501, 451 Pitt Street	Southern	84	$480,000	Jun-15	$5,714

Source: Ray White

*Includes 4 carspaces

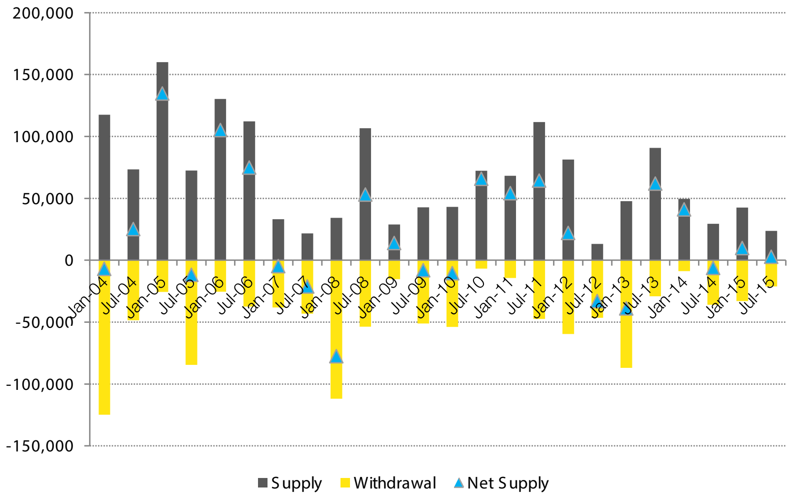
Sydney CBD Office

Investment Yields



Over the past 18 months investment yields have seen strong downward compression across key investment assets most notably the CBD office market. Demand by both offshore and domestic investors given the strong weight of funds has resulted in a swift decline just this year, the recent acquisition of the Investa portfolio is reported on a yield of circa 5% which will set a new benchmark for CBD asset yields. Despite this decrease, the spread to bond remains high given the current low interest rate; the 10 year bond rate of 2.5% and the expectation of continued low rates will ensure that capitalisation rates will further reduce in the short term. Given the limited supply of quality prime assets there will be a greater move up the risk curve for Secondary assets, this has been occurring and the yield gap did reduce to 175 basis points in late 2014. There has been a lag in this filtering through to the Secondary market given the swiftness of the latest Prime yield reduction however the expectation is the gap between Prime and Secondary to again narrow to around 125–150 basis points by the end of the year.

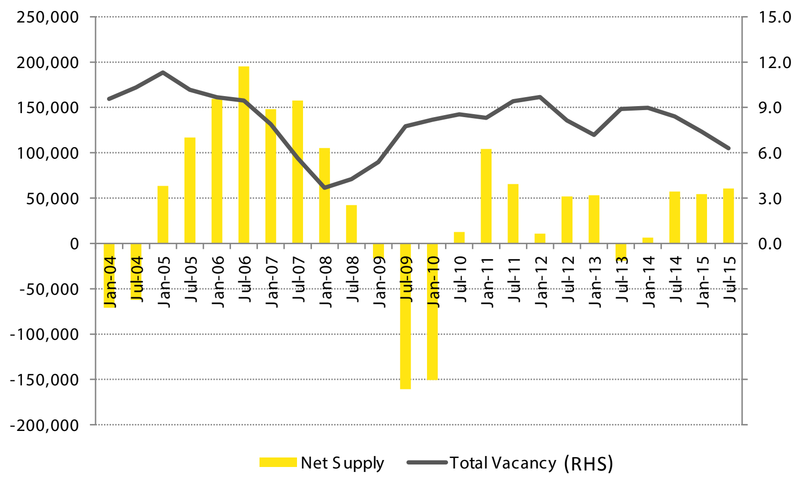
Sydney CBD Office
Net Supply (sqm)



Source: Property Council of Australia

Over the past 18 months the Sydney CBD office market has been in position where new supply additions have been counteracted by withdrawal of stock. This net supply position has aided in the reduction of the overall vacancy rate, however this trend is about to change with the anticipated completion of 670,000sqm of new office stock over the next three years. While withdrawal of stock will continue for refurbishment, this supply will subsequently come back on line with only limited stock being removed completely from the office count. The most anticipated completions are International Towers with the first completion (Tower 2) due in early 2016 (87,500sqm) with the remainder of the office properties on this site expected to be completed by mid-2017 adding 179,000sqm.

Sydney CBD
Net Absorption (sqm) v Total Vacancy (%)



Source: Property Council of Australia

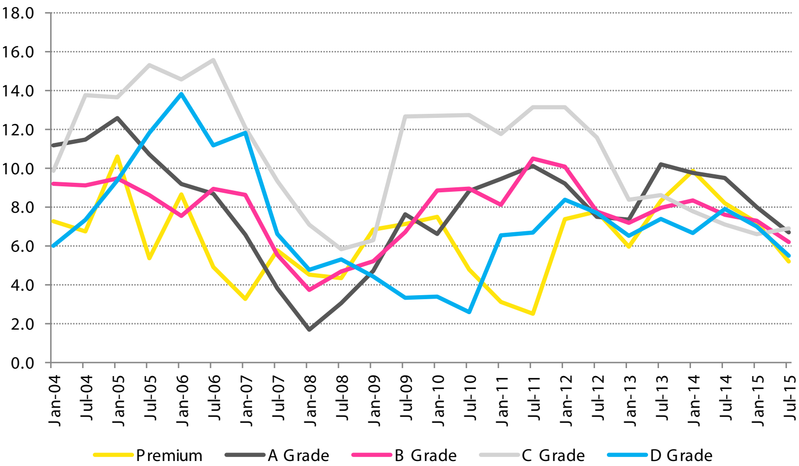
The Sydney CBD continues to boast the lowest vacancy rate of any CBD across Australia as at July 2015. Currently the total vacancy rate is 6.3% including a small sublease factor of 0.4%, the Sydney CBD office market currently has 311,678sqm vacant which has shown a strong absorption rate of 60,405sqm for the six months to July 2015. This is the third consecutive six month period of net absorption of over 50,000sqm, coupled with net supply over the last 18 months of just 5,485sqm highlights the rebound in white collar employment and business confidence. Technology continues to be a driving force for new tenancies within the CBD, while finance and professional services have also increase their footprint on the city. The greatest demand has come from the Core and Midtown precincts which yielded a 36,926sqm and 18,061sqm respectively increase in occupied stock over the last six months.

Sydney CBD fundamentals are performing well with strong demand over the last 18 months coupled with limited net supply bringing vacancies down to just 6.3%. High supply projections over the next few years however could dampen these current positive results.

Level 8, 9 Barrack Street

Sydney CBD Office

Vacancy by Precinct (%)

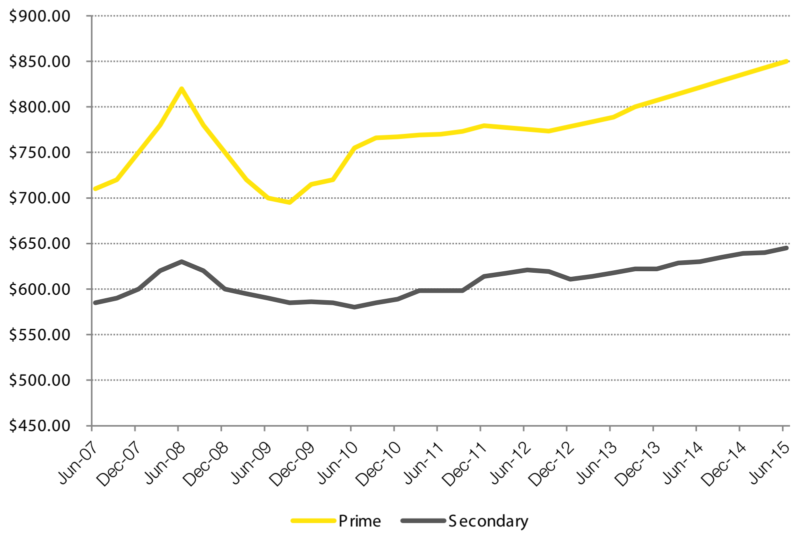


Source: Property Council of Australia

Across the total Sydney CBD the tight vacancy rate of 6.3% has resulted in all quality grades witnessing a decrease in available stock. The flight to quality has ensured that the Premium market continues with the lowest vacancy rate of just 5.2% representing 41,547sqm, A grade slightly higher at 6.7%. The standout being the D grade market, mostly catering for those smaller tenancies; however this market is the smallest across the CBD, vacancy of 5.5% this represents just 10,464sqm. C Grade is the only quality grade which resulted in a small increase in vacancy to 6.9% in July 2015 up from 6.6% in January 2015, while B grade has yielded a six year low at 6.2%. Given the volume new stock to enter the market and known pre-commitments the higher A grade vacancy is likely to be a feature seen in this market for the short to medium term.

Sydney CBD Office

Net Face Rents ($/sqm)



Source: Ray White

The Sydney CBD has been in a period of stability in rents since 2010, over the last two years there was a slight pick-up in the face rents however within the 3.5%–4.0% which is somewhat in line with set rental increases within existing leases particularly given the current low CPI environment. The Prime market has shown a greater increase given the tight vacancy environment and for the first time since the GFC period incentives have started to show greater downward momentum now averaging in the 25% to 30% range which has a positive effect on the effective rental position which has recorded growth over the past year of 9.4% in the Prime market. However for this end of the market there is a greater emphasis by businesses to provide greater wellbeing features for their staff so those properties which offer access to better quality services will continue to be highly sought after.

Secondary assets have a greater variation in rents achieved depending on quality, location, size and services and currently average $645/sqm, this market has a different view on incentives and lease term therefore can range between 10% and 30%.

Table of Leasing Transactions

Address	Area (sqm)	Lease Start Date	Lease Term	Gross Face Rent ($/sqm)	Tenant Name
S801, 160 O'Connell Street	130	Aug-15	2	650	DD Property
S1501, 68 Pitt Street	180	Aug-15	5	809	Network Synergy Corporation
S2302, 45 Calrence Street	519	Aug-15	5	871	NSW Business Chambers
S703, 66 Hunter Street	64	Aug-15	3	800	Lanyon Asset Management
S504, 46 Market Street	242	Jul-15	1.5	500	Maestrano
S802, 117 York Street	687	Jun-15	2	174	Financial World
S202, 50 York Street	232	May-15	3	600	JXT
S201, 50 York Street	77	Mar-15	2	650	Web Salad

Source: Ray White

The total Sydney CBD office market is showing great results with low vacancies and high tenant demand translating into improved rental growth.

Low interest rates and weight of funds domestically and abroad has resulted in sizeable reductions in yields which is likely to continue given the wide spread to bond rate. The strata market has also been positively affected with record highs in capital values, this driven my local investors looking for alternative investment options and foreign buyers seeking exposure within a Prime Australian market.

Ray White®

Research

Ray White Commercial (Office Sydney Leasing)

Vanessa Rader
Head of Research

T (02) 9249 3724
M 0432 652 115
E vrader@raywhite.com

Anthony Harris
Director

T (02) 9249 3709
M 0409 319 060
E aharris@raywhite.com

Jeremy Piggin
Director

T (02) 9249 3778
M 0413 336 161
E jpiggin@raywhite.com

Andrew Telepis
Director

T (02) 9247 3709
M 0415 972 696
E atelepis@raywhite.com

Christian Minards
Associate Director

T (02) 9249 3700
M 0447 777 037
E cminards@raywhite.com

Taylor Yankos
Property Officer

T (02) 9247 3709
M 0468 894 170
E tyankos@raywhite.com

raywhitecommercial.com