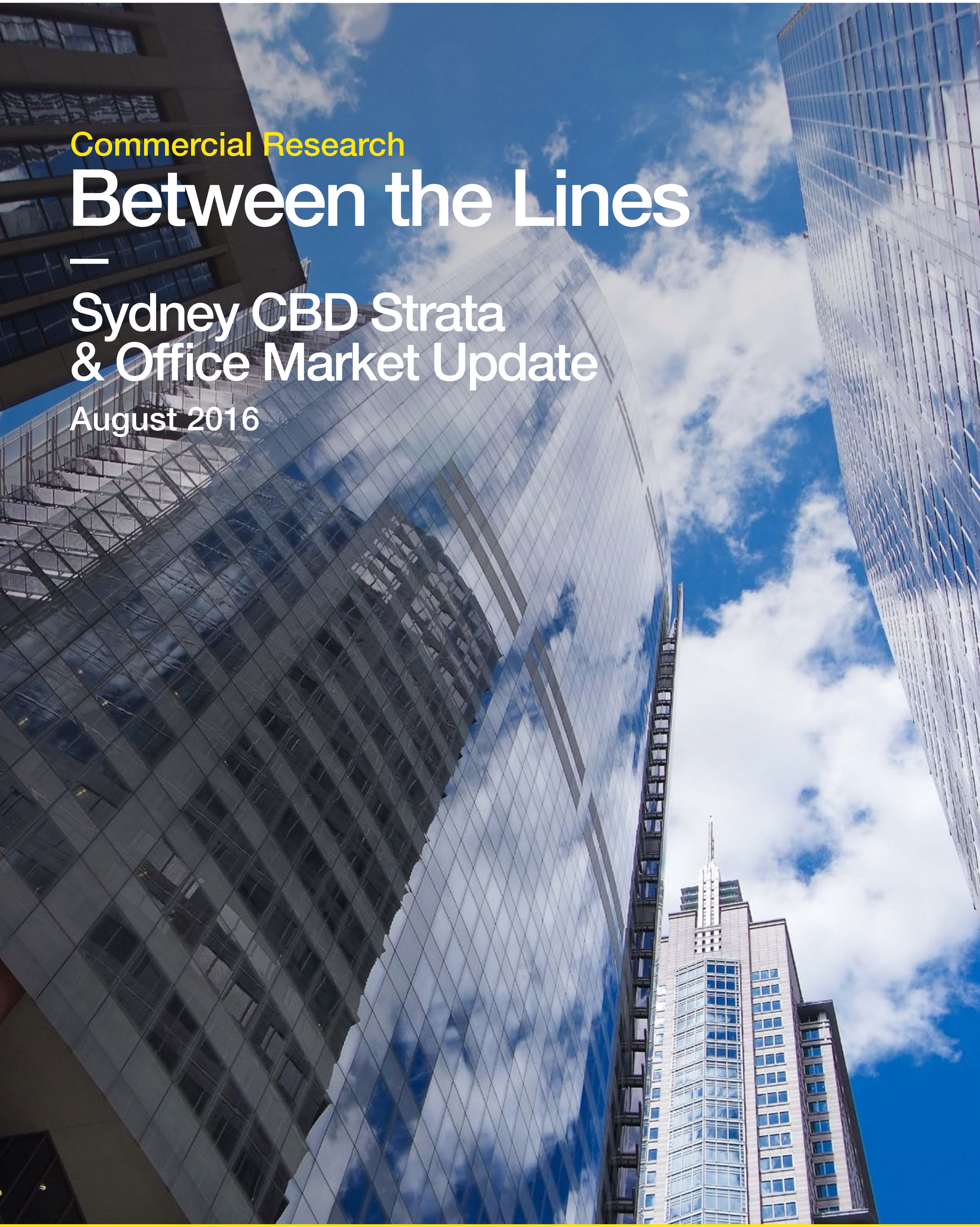
Ray White

Commercial Research

Between the Lines

Sydney CBD Strata & Office Market Update

August 2016

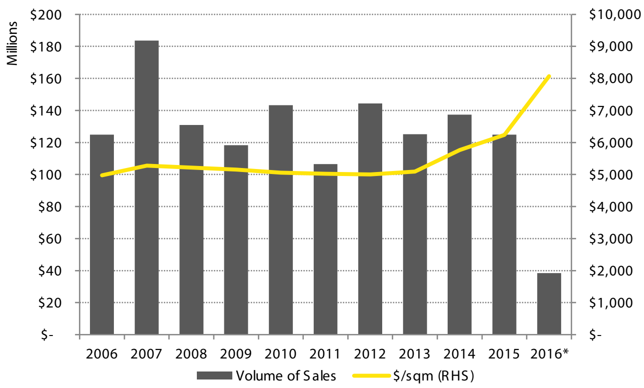


The trends around 2015 for the Sydney CBD Office market have continued into 2016 with vacancies falling to new lows and growth in effective rents outperforming. Face rents have shown strong increases for both prime and secondary spaces, while incentives are more commonplace in the 20% range, a level unseen in this market for over 10 years.

For the strata investment market, while assets are tightly held, high demand has resulted in unexpected levels of growth nearing 30% on last years results. The average capital value is now recorded at over $8,000/sqm this level of growth has been unseen over the last ten years.

Sydney CBD Strata

Volumes v Capital Values



Source: Ray White, Cityscope

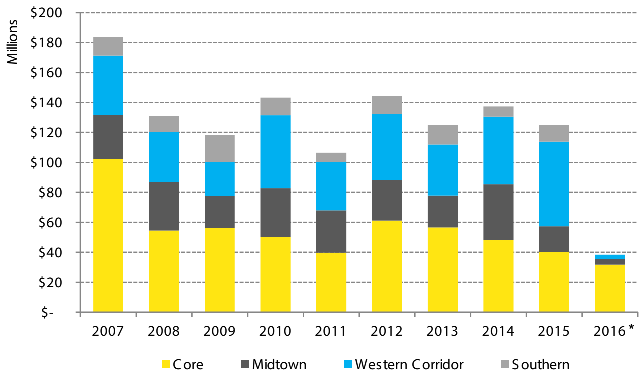
*To 30 June

The Sydney CBD Strata market has continued its growth profile of 2015 into the first half of 2016. Despite a limited pool of sales transactions this half year ($38.407 million), the overall capital value for strata premises has grown 29.33% on 2015 results to average $8,067/sqm across the CBD. This rate of growth exceeds the total increase in values achieved during the period between 2006 and 2015 where total growth of 25.33% was achieved. Interest in Strata office offerings have continued from an active 2015, where competition for product was driven heavily by the low cost of financing together with the strength of the broader CBD office market motivating occupiers to shelter from rental increases and investors to capitalise on rising rents. During this six month period a number of larger floor strata premises were sold bringing the average sale price up to $1.324 million a 56.94% increase on 2015 highlighting the ability for purchasers to finance well above the historical average sale price of around $700,000.

Volume of sales has been limited for the first half of 2016, not due to a lack of investment demand rather a scarcity of stock during this time of robust market fundamental's resulting in low vacancies and growing rents.

Sydney CBD Strata

Sales Volume by Precinct



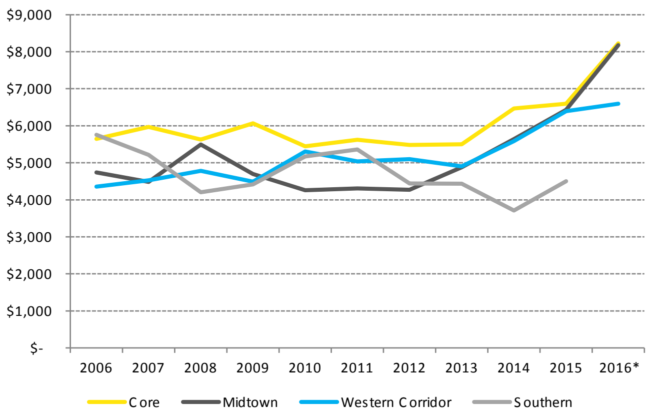
Source: Ray White, Cityscope

*To 30 June

With only $38.407 million changing hands across the CBD during the first half of 2016, the dominance of the Core precinct is somewhat surprising. The volume of sales in the Core represents 82.86% of all sales with the total of over $31 million already not dissimilar to the 2015 full year result of $40.285 million. The average sale price across the Core is at a high $1.872 million driven by a number of larger full floor sales given the average area of each transaction being 228 sqm, more than doubling last year's result of just 103sqm. Midtown and Western Corridor recorded sales of $3.648 million and $2.936 million respectively well below the first half 2015 results. Unsurprising however is the lack of sales in the Southern precinct, historically representing the most limited turnover, this tightly held precinct has recorded no sales in 2016 thus far and despite demand high, the expectation for high sales turnover is limited.

Sydney CBD Strata

Capital value by precinct ($/sqm)



Source: Ray White, Cityscope

*To 30 June

Given the limited pool of sales evidence there is some volatility in the capital values achieved by precincts. The Core however accounting for the majority of sales represents the most reliable result recording an average result of $8,223/sqm highlighting growth from the 2015 annual result of 24.67%. The Midtown also witnessed a strong increase, up 27.24% to $8,179/sqm a value similar to the Core, however given this is based on the small turnover of just $3.648 million this rate may see some movement over the remainder of the year. Similar to this is the Western Corridor with sub $3 million changing hands however recorded a more normalised level of growth of 3.13% to $6,597/sqm while the Southern precinct which is tightly held recorded no transactions so far this year.

The average area of core transactions is 285sqm, more than doubling last year's result of just 103sqm highlighting some full floor sales.

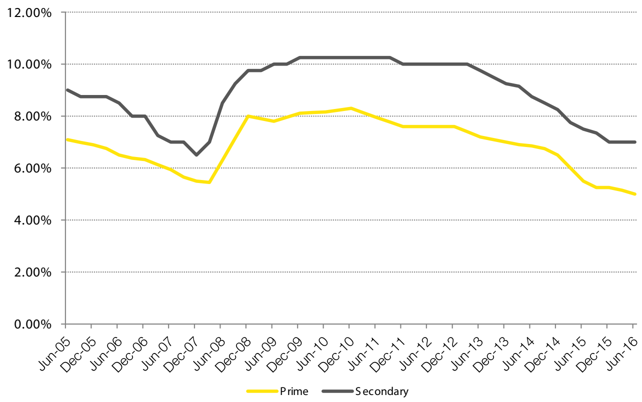
Table of strata sales

Address	Region	Area (sqm)	Sale Price	Sale Date	$/sqm
Suite 1503, 109 Pitt Street	Core	56	$500,000	Apr-16	$8,929
Level 5, 131 Macquarie Street	Core	630	$5,850,000	May-16	$9,286
Suite 608, 250 Pitt Street	Midtown	30	$243,000	Apr-16	$8,100
Suite 704, 99 Bathurst Street	Midtown	107	$1,075,000	Apr-16	$10,047
Lot 7, 432 Kent Street	Western Corridor	206	$1,356,750	Feb-16	$6,586
Suite 1402, 447 Kent Street	Western Corridor	91	$564,000	Feb-16	$6,198

Source: Ray White

Sydney CBD Office

Investment Yields

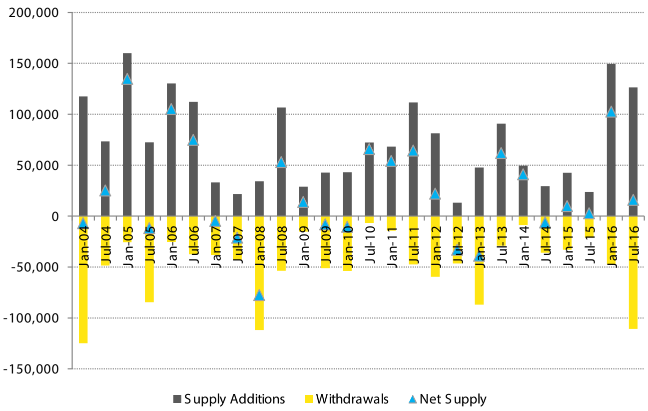


Source: Ray White

Investment yields saw a significant fall this time last year helped along by the sale of the Investa portfolio for a reported 5.00% yield. This brought down the average rate considerably and despite further transactions around this rate there has been little more downward momentum in the average yields across both Prime and Secondary. Continued reducing interest rates and improvements in the rental position across the Sydney CBD has done much to improve sentiment and drive investment demand, however already tight yields has highlighted a somewhat bottom to the yield curve. Ray White Commercial has recorded the current average yield at 5.00% down from 5.50% 12 months ago, with the Secondary average of 7.00% representing the same 50 basis point decline over the year. Some of the larger sales recorded this year include the Macquarie Group occupied property at One Shelley Street, which sold to Charter Hall/Morgan Stanley for $525 million representing a 4.90% yield. Another prime quality asset; 420 George Street, which Fortius Funds Management sold a 75% stake in to Investa Property Group for $442.5 million, this being a yield of 5.30%.

Sydney CBD Office

Net Supply (sqm)

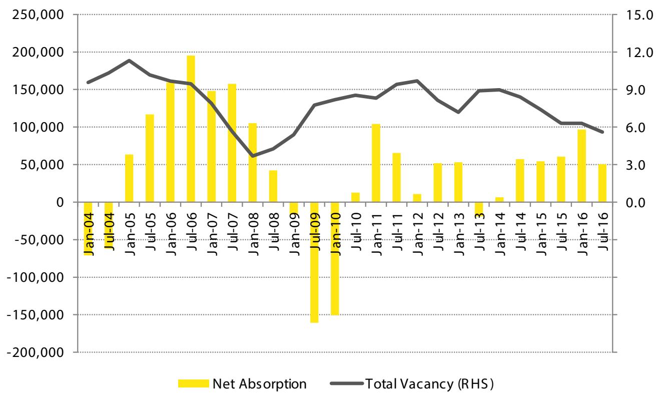


Source: Property Council of Australia

The total size of the Sydney CBD office market has seen little movement in size over the last six months despite 126,474sqm of new premium space entering the market. With withdrawals of over 110,000sqm, this has resulted in a net supply addition of just 15,743sqm. New supply which was added this year include Tower 3 at International Towers Sydney providing just shy of 80,000sqm of quality stock occupied by KPMG and Lend Lease together with Mirvac's 200 George Street (EY, Mirvac) providing 38,676sqm in the Core. A further 140,000sqm is due for completion by the end of year including Tower 1 at Barangaroo as well as Charter Hall's 333 George Street and a number of refurbishment projects. It appears that Sydney CBD is coming to the end of its supply pipeline with 2017 anticipated to only see 25,000sqm added followed by 66,000sqm in 2018 with a further 84,000sqm mooted.

Sydney CBD

Net Absorption (sqm) v Total vacancy (%)



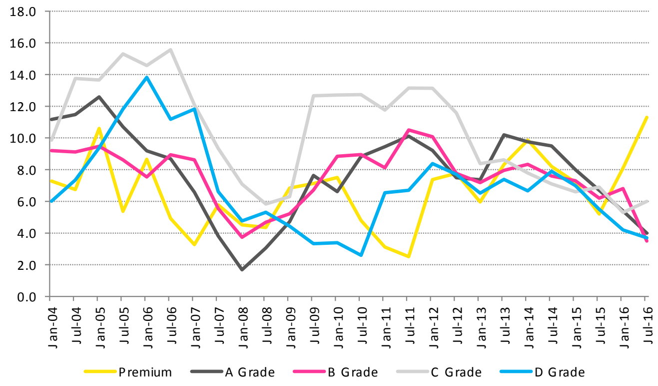
Source: Property Council of Australia

Net absorption has had a pleasing result yet again during the first half of 2016 recording 50,500sqm change in occupied stock. This is the fifth consecutive quarter of over 50,0000sqm take up recorded, highlighting the strong demand for office space within the Sydney CBD, far ahead of other CBD office markets across the country. Demand has come from a wide variety of tenants including Professional, Business, Property Services together with Technology users both new to the CBD and expanding existing footprints. This strong increase in absorption coupled with the rather low net supply situation (given strong withdrawals) has had a sizeable reduction in the vacancy situation compressing 70 basis points to the eight year low of just 5.6%. With the outlook for limited new supply and a continued hunger by tenants in the CBD there is scope for some further slight compression to this total vacancy figure stimulated more so from the strong performing secondary market.

Sydney CBD has yet again displayed pleasing results with continued strong take up translating into a strong compression in vacancy to just 5.6%. While new completions have been high this year, withdrawals along the new transport corridors have done much to keep net supply levels down, assisting in maintaining this low vacancy rate.

Sydney CBD Office

Vacancy by Precinct (%)



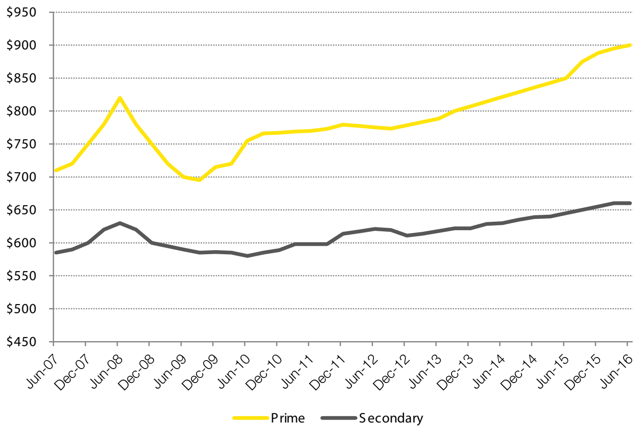
Source: Property Council of Australia

The total Sydney CBD office market has dropped its vacancy rate to just 5.6% for July 2016 after maintaining a rate of 6.3% for the last two periods (July and January 2015). The reduction in vacancies has been strongly a secondary story with B grade outperforming reducing to just 3.5% this period which was undoubtedly aided by stock withdrawal. A grade vacancies has also fallen to now represent just 4.0% however the high supply completions in the Premium grade has seen vacancies grow for the second consecutive period from 5.2% in July 2015 to 11.3% this period. This growth in Premium vacancies was as expected due to the uncommitted space being added to the market and may take some time to be absorbed given the high expense associated with this quality of stock. D grade despite its small size has continued to fall now just 3.7% while the C grade market was the only other quality grade to show an increase, up from its 15 year low of 5.3% recorded January 2016 to 6.0% this period.

Upper Ground, 441 Kent Street, Sydney

Sydney CBD Office

Net Face Rents ($/sqm)



Source: Ray White

With vacancies keeping a reasonably prolonged low rate, face rents have now taken a more positive turn and so too have incentives. Over the last year, we have seen the prime face rent grow by 5.88% to now average $900/sqm, yet within the broad range of $700/sqm to over $1,000/sqm. The secondary market has also seen a rapid increase in face rents albeit not at the same rate growing by 2.35% to average $660/sqm. Incentives have shown some compression from their highs during 2013/2014 which ranged up to 35%, this fall to current prime low of 25% (or sub 20% in the smaller secondary market) improving the effective rental position also. The smaller space occupiers have moved their interest in purchasing small suites to capitalise on low interest rates and shelter from these rising rents which has resulted in an influx of demand which has driven capital values up. With options to purchase limited these occupiers have had to look again at rental accommodation and we expect quality offerings to continue to be absorbed resulting in a swift uptick in face rents particularly in the sub 200sqm size range.

Table of leasing transactions

Address	Area (sqm)	Lease Start Date	Lease Term	Gross Face Rent ($/sqm)	Tenant Name
Part Lvl 10, 50 Margaret Street	305	Jul-16	5	$785	Successful Ways
Suite 401, 25 Lime Street	176	Aug-16	3	$775	Ark International
Part Lvl 5, 35 Clarence Street	469	Aug-16	3	$751	Pet Circle
Level 2, 50 Margaret Street	709	Aug-16	6	$765	Bridge Lawyers
Part Lvl 3, 109 Pitt Street	74	Aug-16	3	$730	Rowan Legal
Level 20, 227 Elizabeth Street	905	Sep-16	5	$785	Stacks

Source: Ray White

The Sydney CBD has yielded strong results over the past two years despite being amidst one of the largest construction cycles ever recorded. Strong demand from a widening occupier base together with strong withdrawal of stock has aided in vacancy levels maintaining a prolonged low level.

This has resulted in some good results for the rental market with face growth higher than prior years and incentives reducing after a long term high. Investment for both freehold and strata assets have been robust resulting in new lows in yields and highs in capital values. With the outlook for white collar employment strong and new completions reducing the short to medium term appears bright for the Sydney CBD office market.

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