THOUGHT LEADERSHIP

IS THE REDUCTION IN **CHINESE INVESTMENT** A **TURNING POINT** FOR THE SYDNEY OFFICE MARKET?

BY ANTHONY HARRIS

AS WE'VE SHARED PREVIOUSLY, THERE ARE KEY FACTORS DRIVING UP RENTS AND CAPITAL VALUES IN THE OFFICE MARKET, SUCH AS THE CONVERSION OF OFFICE BUILDINGS TO RESIDENTIAL, THE ACQUISITION OF OFFICE BUILDINGS FOR THE SYDNEY METRO RAIL, A STRONG DEMAND FROM TECH COMPANIES TAKING SPACE IN SYDNEY, AND MASSIVE INVESTMENT FROM CHINA INTO AUSTRALIAN REAL ESTATE.

While it may feel sometimes like these activities might continue for some time to come, every property cycle has a few turning points that can signal to the entire industry what, in retrospect, we all saw coming.

THREE KEY TURNING POINTS ARE:

1. The Chinese State Government's announcement of reduced capital outflow from China into commercial and residential property. The strong activity of Chinese capital investment in the Sydney office market in many cases wasn't based on fundamentals, current rental rates or potential development outcomes.

2. The massive withdrawal of stock from office to residential conversion, as well as the Metro train line, has come to an end. So too has the frenetic activity of displaced tenants leasing office space.

3. The pace of tech companies taking up space has slowed. Many of the tech companies I speak with are running on venture capital funding, in the hope that the products and software they're developing will break into new markets and turn a profit. But it's important to be realistic - not every tech company can be the next Freelancer or Atlassian.

While I don't believe we'll see huge impacts on the office market in 2018 like we did post GFC, these key turning points are set to take the heat out of the market and stabilise rents. I'm already seeing many Chinese property companies reducing staff and disposing of leases as their enterprises in the Sydney property market pull back.

Some of my more prudent Lessors are doing thorough due diligence when dealing with rapidly growing tech companies. Looking at the P&Ls for these potential tenants, in some cases these companies are running at losses, surviving only on capital injection from investors until they turn a profit.

IN THE LAST TWO YEARS I HAVE SEEN SOME UNUSUAL PROPERTY TRANSACTIONS, SUCH AS:

- Overseas Chinese investors buying strata offices, site unseen, purely to get money into the country as opposed to the features and benefits of the actual property. I have dealt with a number of Chinese buyers who purchased office properties at auctions by looking at marketing slides, rather than actually seeing the property. We saw these types of strata sales at 107 Pitt Street, 23 Hunter Street and 23 O'Connell Street.
- Office tenants trying to trump each other on leasing deals, with displaced tenants rushing to secure office spaces in buildings now being demolished. We saw this with incoming tenant demand at 28 O'Connell Street, 50 Margaret Street and 66 Clarence Street. We acted on a sublease deal at 4 Martin Place, where the sublease rate was about 25% above the rental paid under the direct lease.
- Tech companies changing their rental profile, going from paying a conservative $450 psm in the city fringe to now paying over $1,000 psm for B-grade space in the city centre.
- Some displaced tenants from the Metro acquisition sites spending compensation monies on fit outs to higher levels than is normal. One example that comes to mind is a legal user spending over $3,000 psm on a fit out with compensation monies, when this should have otherwise been closer to $1,000 psm.

All of these factors seemed irrational to me at the time,

but were based on market pressures that have now gone away. Of course, it will be an interesting end to the year to see what happens to capital values, office rents and lease incentives. In my opinion, the lack of new office supply will save us from rent reductions, but I believe we're now at the peak of the rental and sales cycle.

CONTACT ME TODAY IF YOU'D LIKE TO DISCUSS YOUR TENANCY REQUIREMENTS, OR IF YOU HAVE A SPACE YOU'RE INTERESTED IN LISTING.