Ray White

Commercial Research

BETWEEN THE LINES

Sydney CBD Office Market Update

February 2018

Sydney CBD Office Market

Total Stock Level 5,023,997sqm

New Supply	↓	37,376sqm
Withdrawals	↔	99,695sqm
Net Supply	↓	-62,319sqm

Premium ↓ **6.9%**

A Grade ↔ **3.7%**

B Grade ↓ **4.8%**

C Grade ↓ **3.7%**

D Grade ↓ **2.1%**

Direct Vacancy ↓ 4.4%

Sublease ↓ 0.3%

Total Vacancy ↓ 4.6%

Net Face Rents

Prime ↑ $1,000/sqm

Secondary ↑ $825/sqm

Incentive

↓ 10–15%

Investment Yields

Prime ↘ 4.75%

Secondary ↓ 5.75%

Strata Capital Values by Precinct

Core ↑ 40.1% to $11,260/sqm

Midtown ↑ 21.4% to $9,808/sqm

Western Corridor ↑ 21.6% to $8,865/sqm

Southern ↑ 19.2% to $7,266/sqm

Strata Sales Volume

2017* ↓ -6.1% to $145.06 mill

Total Strata Capital Values

2017* ↑ 33.0%+ to $10,127/sqm

Sources: Property Council of Australia & Ray White

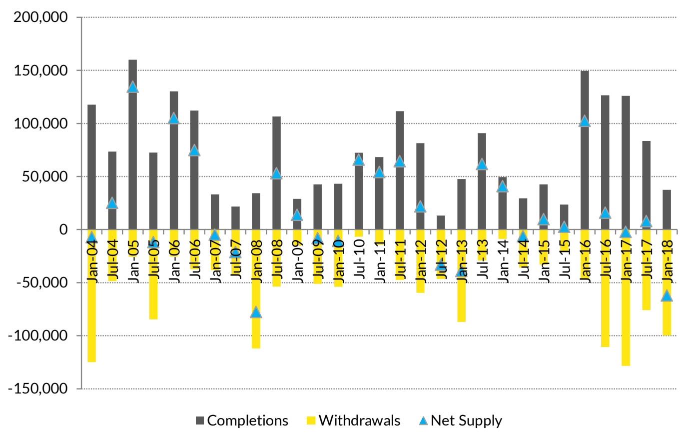
The fire in the Sydney CBD market has started to settle with net absorption of just 345sqm recorded the six months to January 2018, despite a large withdrawal of stock. As a result, this stock level change has seen vacancy continue to compress to a low of 4.6%.

Strong occupier demand over the past four years has fuelled rental growth now continuing due to lack of stock, while investment interest driven domestically has ensured that yields too have bypassed prior historic lows.

Even the smaller strata market has benefitted with capital values over 25% up on 2016 results as investors flock and owner occupiers try to shelter from continued rent hikes.

Sydney CBD Office

Net Supply (sqm)

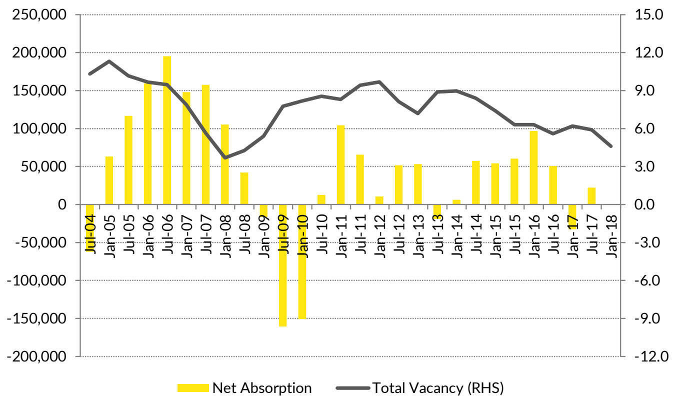


Source: Property Council of Australia

After four years of strong supply completions, its first decrease in total stock size. Now representing 5,023,997sqm, the withdrawal of 11 buildings, (due to the vast infrastructure projects within the CBD, refurbishments and conversion) has resulted in net supply of -62,319sqm for the six months to January 2018 or -54,606sqm for the 2017 calendar year. The last six months saw limited major completions with re-entering refurbished stock dominating the new additions, including 10 Shelley Street bringing back 27,718sqm into the market, while the only new completion being International House Sydney of 6,885sqm. Looking ahead, 2018 will bring over 85,000sqm into the market, led by refurbishment projects (over 80% precommitted) including Darling Park Tower 2 and 140 Sussex Street.

Sydney CBD

Net Absorption (sqm) v Total Vacancy (%)

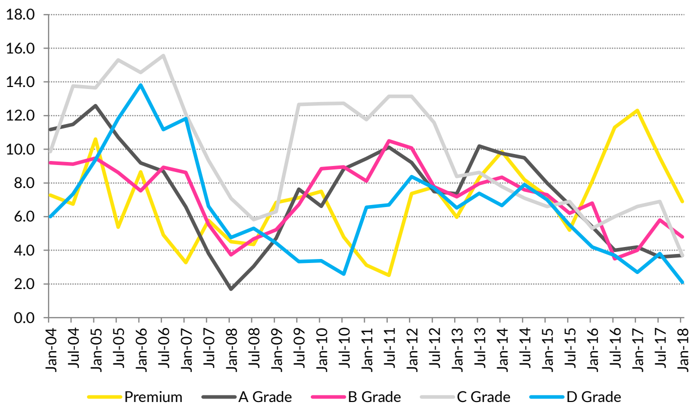


Source: Property Council of Australia

The six months to January 2018 has recorded limited change in absorption, take up this period was recorded at just 345sqm taking the annual rate to 24,827sqm. After a number of consecutive 50,000sqm+ six monthly absorption rates during the 2014–2016 period, the Sydney CBD office market has entered a new phase of subdued demand. Take up levels have seen greater volatility more recently however the strong reduction in overall vacancy for the market has been driven entirely by withdrawal of stock. Currently vacancy across the CBD is recorded at 4.6%, 70 basis points better than July 2016 results and the lowest rate since the GFC period. Vacancy is represented by 233,318sqm of the market with the sublease factor minimal at just 0.3% which highlights the limited opportunities for occupiers which supports the continued upward pressure on rents across the city.

Sydney CBD Office

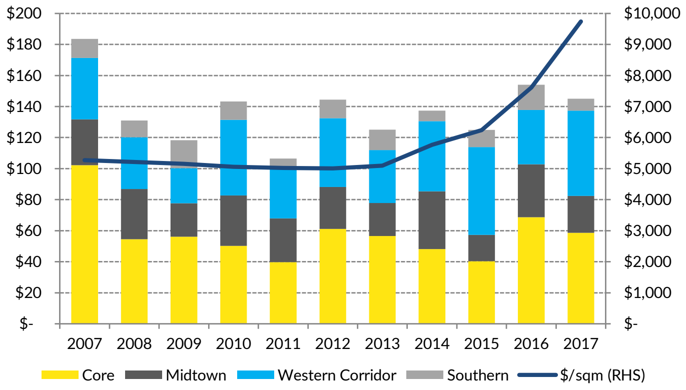
Vacancy by precinct (%)



Source: Property Council of Australia

The Sydney CBD office market has recorded outstanding results over the last three years and now shares the title of the lowest CBD vacancy across Australia with Melbourne. Currently recording 4.6% this represents 233,318sqm of vacant stock which is heavily weighted across Premium and A grade stock given the high supply additions witnessed in this market over the last few years. Premium grade stock has witnessed the greatest decrease in vacancy over the past 12 months, currently 6.9% after peaking at 12.5% in January 2017. A grade vacancy has recorded stable results with a minor increase of 10 basis points from six month ago to record 3.7%. Secondary grade assets have fared well over the last few years due to the high level of withdrawal coupled with increased demand for more affordable accommodation. C grade the most improved, reducing from 6.9% six months ago to just 3.7%, while B grade compressed 100 basis points over the same period to record 4.8%. The small D grade market achieved its lowest rate in history at just 2.1% or 3,794sqm highlighting the difficulty for many tenants to source affordable stock across the CBD.

Sydney CBD Strata
Volumes by Precinct v Total Capital Values

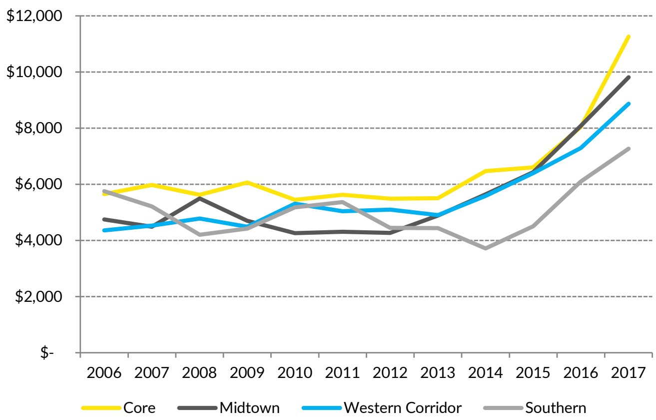


Source: Ray White, Cityscope

The Sydney CBD Strata office market has witnessed outstanding results over the past four years, off the back of the strong increases in rents due to limited vacancies together with low interest rates. After a prolonged period of limited change in values we saw rapid increases, most notable over the past two years, growing values across the total market by 56.2%. Results for 2017 have seen average capital values achieve $9,742/sqm which represents an increase of 27.9% over the year. Volumes in 2017 were slightly down on 2016 results as stock was more difficult to source with limited quality stock entering the market with owners opting to retain their assets, $145.063 million changed hands. The Core and Western Corridor dominating activity representing 78.2% of the total pool of investment with Midtown reducing its volume, while Southern continues to yielded the least volume of transactions.

We have seen interest in CBD strata continue during 2017 as both investors and owner occupiers actively pursue these investments, strong Sydney CBD office fundamentals being the major catalyst for this demand. As such we have seen the average price paid per strata premises average $1.142 million compared to just $844,000 in 2015 and averages closer to $700,000 over the longer term.

Sydney CBD Strata
Capital value by precinct ($/sqm)



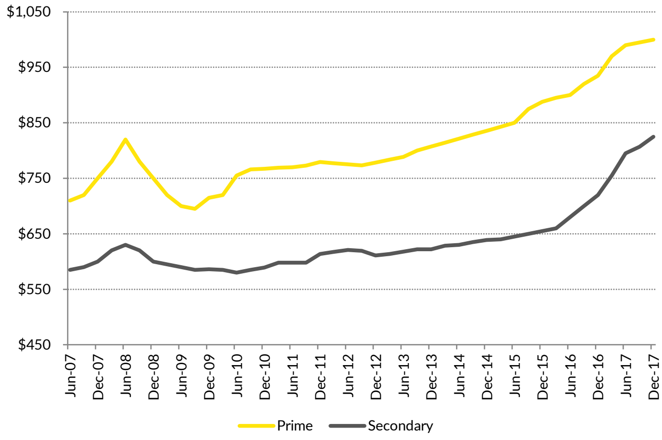
Source: Ray White, Cityscope

With the Core being the most active market, the huge increase in capital values achieved has been determined by large sample of sales, up 40.1% on 2016 results, the Core continues to be the market in most demand achieving average capital value of $11,260/sqm. Midtown comes in second representing growth of 21.4% over the last year, after overtaking the Core as the highest value strata market in 2016, now averaging $9,808/sqm. Western Corridor has seen four strong years of growth increasing values by 80.8% over this period, the last year representing a 21.6% improvement to average $8,865/sqm. The Southern precinct has the smallest stock level of strata property and limited transactions are often recorded, this year the few sales occurred have yielded consistently high values resulting in the average of $7,266/sqm, this being a 19.2% increase compared to 2016, the third consecutive year of double digit value growth.

After a number of years of robust growth in values, it would appear that this level of growth is unlikely to continue at its current pace. While values are anticipated to keep on their upward trajectory their rate of growth is expected to slow as well as volume of sales, as more owners and occupiers opt to hold their assets to shelter from rents or continue to receive high returns during these strong Sydney CBD market conditions.

Sydney CBD Office

Net Face Rents ($/sqm)



Source: Property Council of Australia

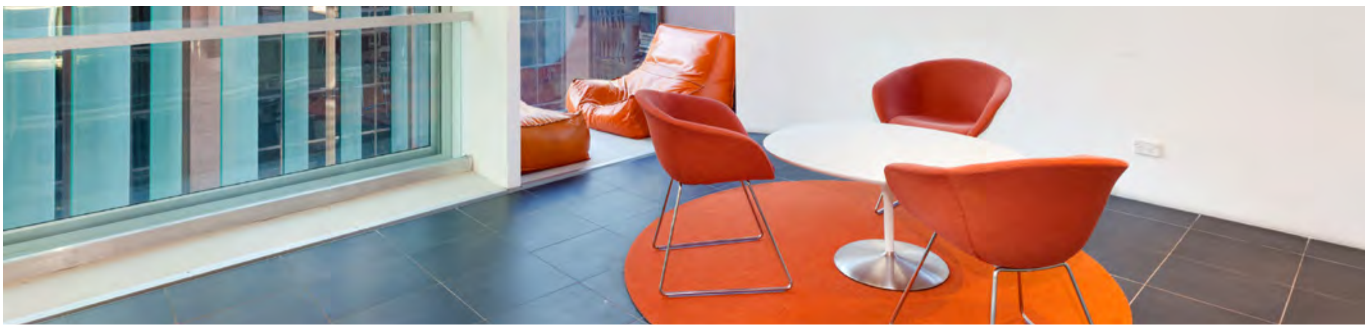
Vacancy levels have been at a prolonged low now for three years and as such we have seen face rents respond favourably and incentives slowly erode out of the market. Over the last year prime net face rents recorded a 14.58% increase, to average $1,000/sqm yet within a range of $925/sqm to $1,100/sqm. Incentives in this market have improved considerably given the strong demand for space and now represent anywhere from 10–20% for this market, or slightly higher for larger, new premium stock.

Secondary assets have also been in strong demand given the large increase in new start up business activity; this is confirmed by the tight vacancy situation across the B, C and D grade assets. Net face rents across secondary can range widely between $700/sqm and $900/sqm with the current average recorded at $825/sqm representing 6.95% annual growth. While this strong growth has been positive over the last three years, affordability continues to be a concern, with many occupiers being priced out of the Sydney CBD market and have considered other markets such as North Shore, City Fringe and Parramatta who have all benefitted from reduced vacancies and their own strong increases in face rents. This has spurred on the co-working sector of the market with many building owners capitalising on the need for serviced office spaces as well other service providers growing their holdings across the CBD.

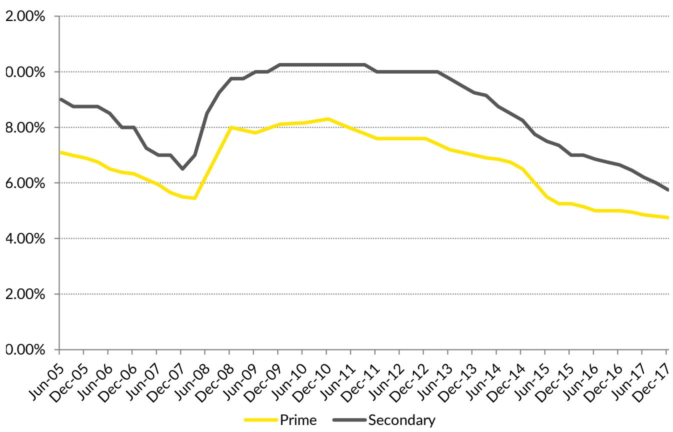
Recent Office Leasing Transactions

Address	Area (sqm)	Start Date	Term	Gross Face Rent ($/sqm)	Tenant Name
25 Bligh Street	175	Dec-17	3	$1,050	Lewis King Blumberg
61 York Street	207	Dec-17	3	$790	Alter Domus
22 Market Street	91	Dec-17	3	$750	Ecovantage
189 Kent Street	278	Nov-17	3	$620	Collaborate Corporation
225 Clarence Street	82	Nov-17	3	$732	Li & Partners
5 Hunter Street	78	Oct-17	4	$692	Financial Education Professionals
28 O'Connell Street	152	Sep-17	3	$1,095	Lyon Solar
50 Margaret Street	140	Sep-17	1	$1,000	Staff Solutions

Source: Ray White



Sydney CBD Office
Investment Yields



Source: Ray White

The performance of the Sydney CBD market cannot go unnoticed; Sydney CBD is the financial hub of Australia with major domestic and international head office locations all within this globally recognised city. As such, this market endures the greatest level of investment interest from home and abroad with funds, trusts, syndicates and privates all vying for a piece of Sydney.

The a new low in prime yields of 5.00% was achieved off the back of CIC's investment into Investa Property Groups portfolio back in 2015, while at this time it represented a 150 basis point fall, it reset market expectation for quality stock. After this time yields have shown further tightening with the most recent transaction announced being the sale of 1 Castlereagh Street for $218 million on an initial yield of 3.71% to an offshore purchaser; as a result overall average prime yields now average 4.75% a new historical low. The gap between prime and secondary has again narrowed due to limited investment options and yield level, with these assets now achieving an average of 5.75% yet within a wide range of values up to 7.50% on the upper end.

Recent Office Strata Transactions

Address	Region	Area (sqm)	Sale Price	Sale Date	$/sqm
88 Pitt Street	Core	102	$1.125mill	Nov-17	$11,029
16 O'Connell Street	Core	266	$3.050mill	Nov-17	$11,466
70 Castlereagh Street	Core	389	$4.900mill	Nov-17	$12,596
22 Market Street	Western Corridor	141	$1.450mill	Nov-17	$10,284
155 King Street	Midtown	31	$381,000	Oct-17	$12,290
234 George Street	Core	64	$975,000	Sep-17	$15,234
301 Castlereagh Street	Southern	45	$340,000	Sep-17	$7,556
99 Bathurst Street	Midtown	128	$1.770mill*	Aug-17	$13,828*

Source: Ray White *includes 1 parking space

The outlook for the Sydney CBD office market continues to be positive, with supply additions heavily demand led and continued withdrawals anticipated over the next couple of years together with favourable white collar employment projections. This will ensure vacancy remains tight and pressure remains on rents and yields; while disruption has been high across the CBD, infrastructure completions over the next few years will bring vibrancy back to the CBD, cementing Sydney as a truly global city.

Research

KNOW HOW

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