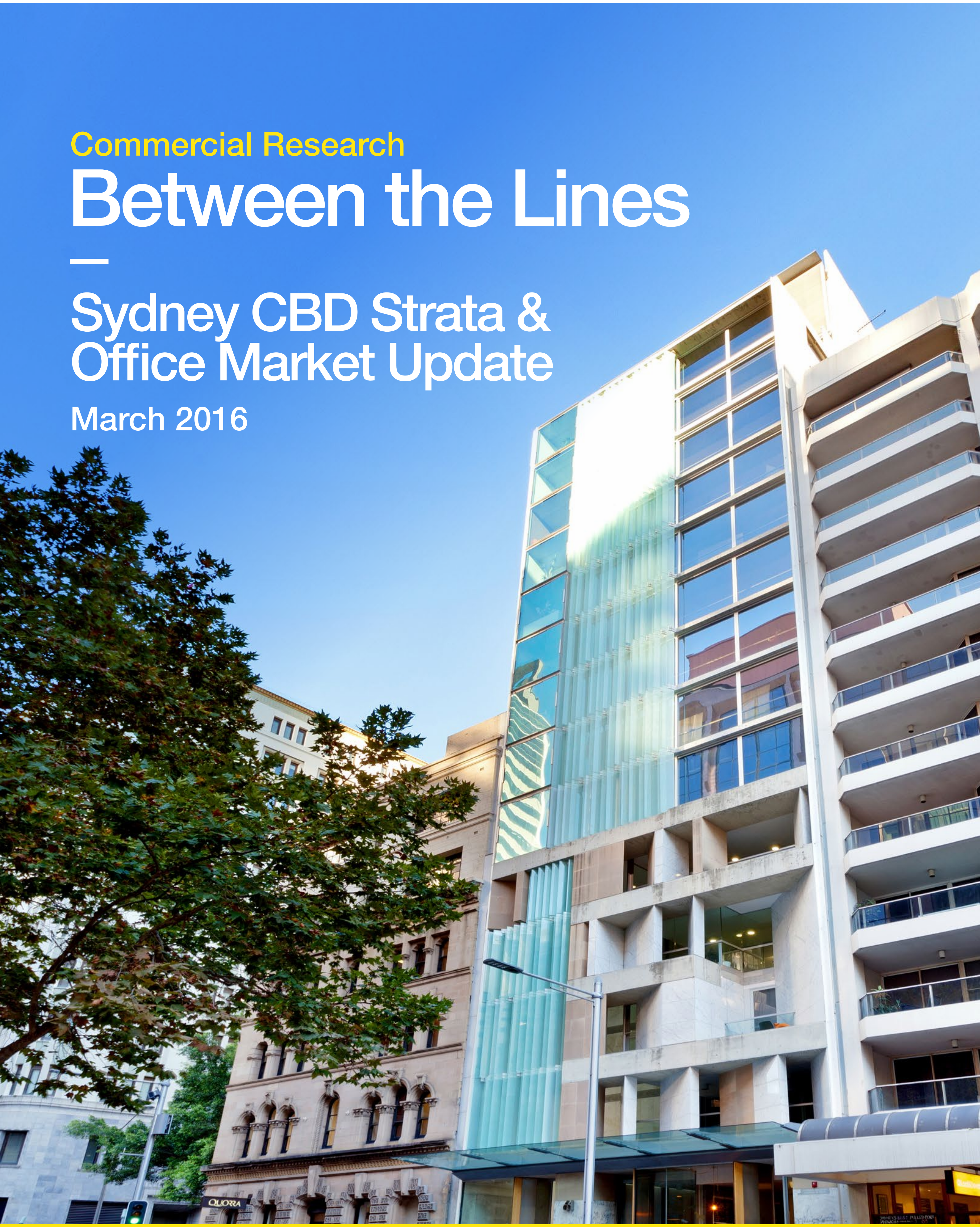
Ray White

Commercial Research

Between the Lines

Sydney CBD Strata & Office Market Update

March 2016

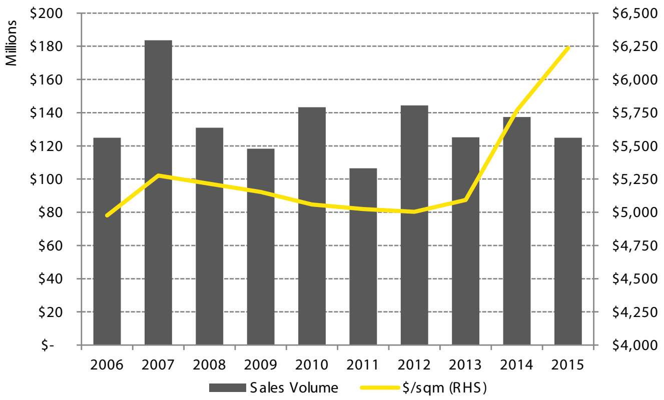


2015 has been a strong performing year for the Sydney CBD office market. A combination of low vacancies and high take up has fuelled some improvement in the leasing market as well as low interest rates and foreign interest putting downward pressure on investment yields.

Supply additions have shown their first period of high results which will be a regular theme for this market. For the strata market, volumes have been limited but capital value have shown outstanding results, growing to a new high across the total market at $6,237/sqm representing an 8.15% increase on 2014 results.

Sydney CBD Strata

Volumes v Capital Values

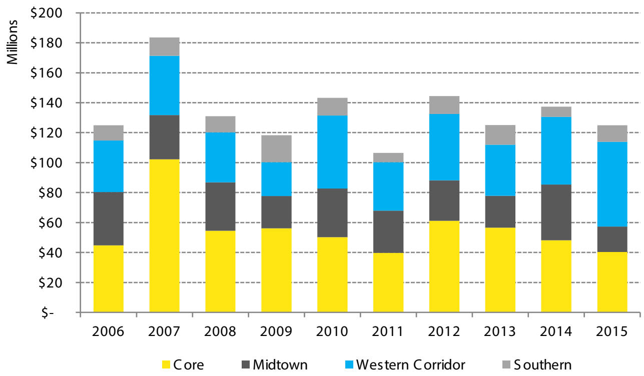


Source: Ray White, Cityscope

The volume of strata office sales in Sydney CBD for 2015 is slightly down from 2014 results with this period recording 148 sales with a total volume of approximately $125 million. This volume is down 9.05% and represents just shy of 20,000sqm of office space. The stand out result however being the strong uptick in capital values over the last two years. The current total average capital value is $6,237/sqm which is 8.15% up on last year or more positive being the increase of 22.48% over the past two years. During 2015 the average sale price increased to $845,000 from $770,000 during 2014 which is indicative of this large increase in value and the appetite by purchasers to buy larger or multiple suites rather than individual small suites particularly given the cost of funding being currently favourable.

Volume of sales has been limited in 2015 despite low interest rates and growing face rents. Traditionally the owner occupier market increases momentum when the broader office market is performing to shelter from rent increases, however despite this investors have been the dominate buyer group.

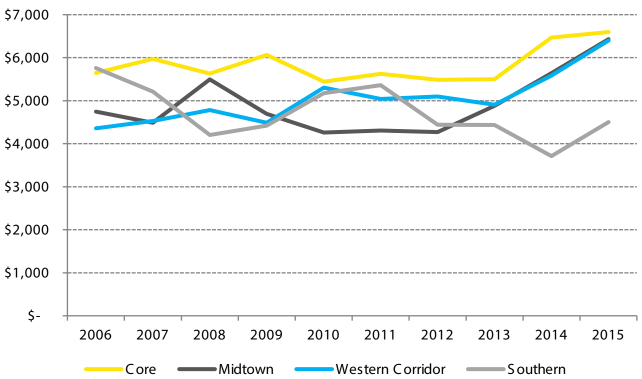
Sydney CBD Strata
Sales Volume by Precinct



Source: Ray White, Cityscope

Investment activity during 2015, while slightly behind the 2014 result shows similar trends in the distribution of sales by precinct. The only market showing significant change being Midtown, with only $17.09 million transacting during 2015, this is down 54.13% since last year. The average size within Midtown has also decreased compared to 2014 representing just 73 sqm. The Western Corridor was the market to benefit from this reduction resulting in the volume of sales to increase from $45.19 million in 2014 to $56.45 million in 2015 and an average sale price of $1.485 million or 231 sqm. The Southern precinct historically has a small share of strata office sales due to the limited stock in this location; however this too has seen an increase, representing 15 sales or $11.07 million up 64.07% on last year. The Core has shown its third consecutive decline in volume of sales, this more traditional CBD strata office location has accounted for $40.29 million of sales across 59 transactions.

Sydney CBD Strata
Capital Value by Precinct ($/sqm)



Source: Ray White, Cityscope

Capital values across all precincts have shown good levels of growth during the 2015 calendar year. Core continues to be the most expensive region of the CBD however resulting in the smallest increase in values over the year, up 2.00% to $6,596/sqm. Midtown and Western Corridor are now very much on par with their values this year at $6,428/sqm and $6,397/sqm respectively, Midtown recording its third consecutive quarter of double digit growth. This year Western Corridor has done slightly better in growth terms up 14.56% with Midtown slightly behind at 13.98%. The Southern precinct has yielded the greatest increase in values, up 21.26% to $4,502/sqm, however this is due to the reduction in values in 2014 (due more to the limited pool of evidence) and the 2015 value recorded back in line with the results of 2013.

Table of Strata Sales

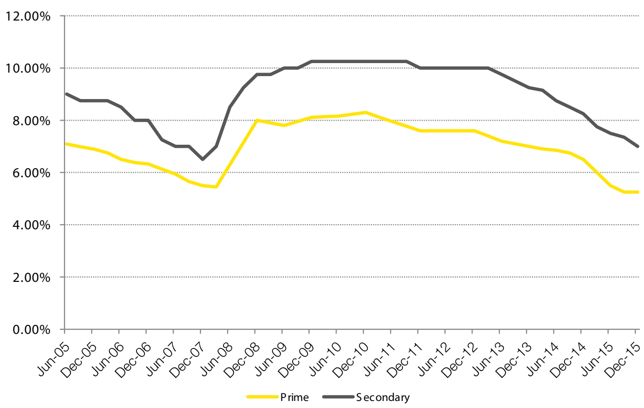
Address	Region	Area (sqm)	Sale Price	Sale Date	$/sqm
Level 12, 88 Pitt Street	Core	338	$2,300,000	Feb-16	$6,805
Level 1, 261 George Street	Core	339	$2,750,000	Dec-15	$8,112
Unit 31, 229 Macquarie Street	Core	26	$275,000	Oct-15	$10,577
Suite 906, 5 Hunter Street	Core	105	$860,000	Sep-15	$8,190
Lot 21,321 Pitt Street	Midtown	77	$670,000	Nov-15	$8,701
Suite 1101, 263–265 Castlereagh Street	Midtown	108	$820,000	Oct-15	$7,593
Lot 68, 22 Market Street	Western Corridor	475	$2,950,000	Jan-16	$6,211
Suite 105 & 106, 50 Clarence Street	Western Corridor	149*	$1,150,000	Oct-15	$7,718
Suite 21, 301 Castlereagh Street	Southern	47	$260,000	Dec-15	$5,532

Source: Ray White

*Includes 1 parking spot

Sydney CBD Office

Investment Yields



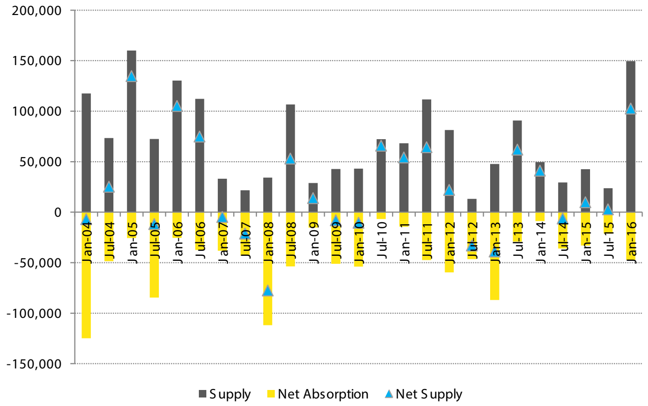
Source: Ray White

Investment yields have seen sizeable compression across most quality asset classes and locations over the past two years. The Sydney CBD has been highly sought after by both domestic and international investors given its attraction as the financial capital of Australia with the greatest volume of office stock. Furthermore the low vacancy rate and positive movements in face rents have been another drawcard for this market, particularly as incentives show some downward momentum resulting in sizeable improvements to the effective rental position. The swift reduction in yields was more obviously early in 2015 particularly given the sale of the Investa Portfolio on a reported yield of 5.00%, keeping the yields stable over the last year at the 5.25% mark. Secondary assets however have shown greater scope for decline continuing to decrease through 2015 to now average 7.00%.

While investment yields have hit a long term low, limited stock, strong demand and low interest rates will likely result in further reductions in the short term.

Sydney CBD Office

Net Supply (sqm)

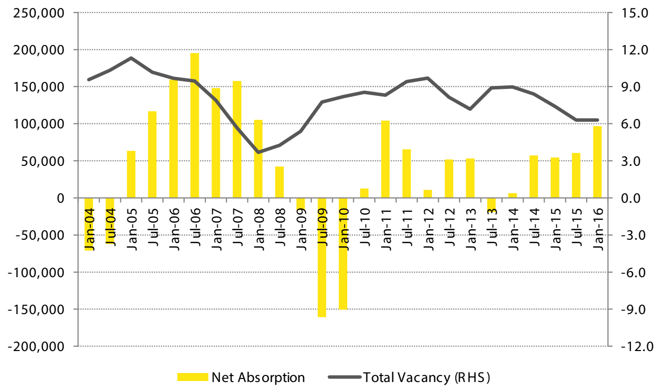


Source: Property Council of Australia

The Sydney CBD has now extended its stock level over 5 million sqm this period, given the strong 102,281sqm of net supply to join the stock count. Key completions over the second half of 2015 include the redevelopment and refurbishments of 5 Martin Place (33,000sqm) and 20 Martin Place (16,000sqm) and a further 12,837sqm in Aurora Place. However most notably being the first stage of the new International Towers Sydney (Barangaroo), Tower 2 of 87,661sqm which is occupied by Westpac and Gilbert + Tobin. Looking ahead, Towers 1 and 3 will be completed by the end of 2016 providing a further 180,000sqm of premium stock to the Sydney CBD skyline, this current construction cycle though about to peak with a further 62,000 sqm to be completed in 2016 via 333 George Street, 190–200 George Street and refurbishments at Governor Macquarie Tower.

Sydney CBD Office

Net Absorption (sqm) v Total Vacancy (%)



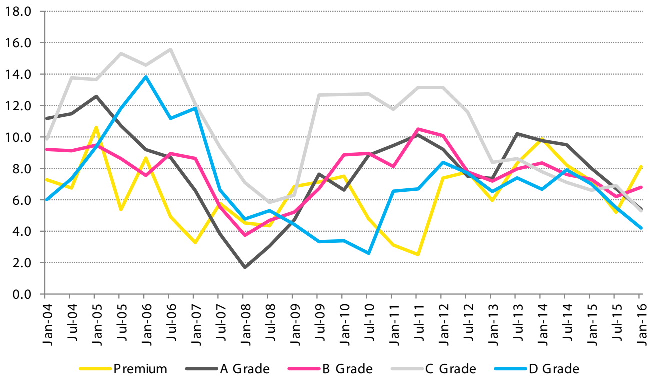
Source: Property Council of Australia

Take up across the Sydney CBD office market has been outstanding for the past two years. During the six months to January 2016, change in occupied stock was recorded at a high 96,745sqm which is almost double the highs achieved the prior 18 months which averaged 57,350sqm. Despite this strong increase in take up, the vacancy position has remained stable due to the high increase in supply recorded in this period. While withdrawals did counteract this somewhat with the net supply addition of around 100,000sqm which resulted in this stable total vacancy of 6.3%.

Sydney CBD has shown pleasing results in terms of vacancies despite large supply additions during late 2015 which has also fuelled the leasing market. Looking to 2016 and beyond, it is unlikely this low vacancy situation will continue given the re-entry of refurbished space and the reshuffle (rather than expansion) of tenants across the CBD.

Sydney CBD Office

Vacancy by Precinct (%)



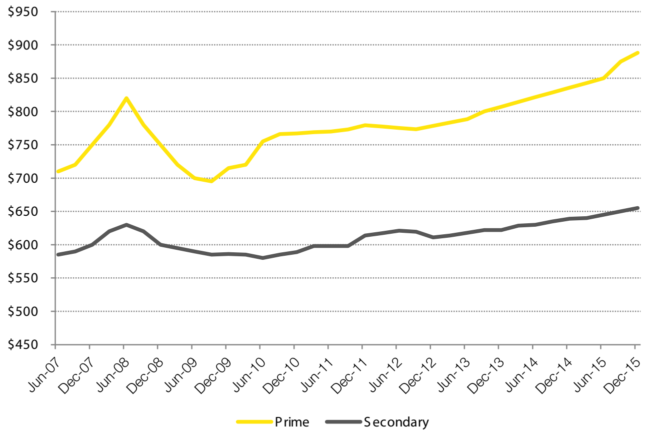
Source: Property Council of Australia

The total Sydney CBD office market has maintained its 6.3% vacancy for the second consecutive six month period with some dramatic changes by quality grade. The large supply additions to the Premium category have resulted in a strong uptick in vacancies for this category increasing from 5.2% in July 2015 to the current rate of 8.1%. B grade is the only other quality grade to witness an increase over this period to now 6.8% which is still a historically low rate, albeit up from the 6.2% recorded last period. The other quality grades have all seen good compression in vacations with A grade down to a tight 5.4%, C grade also now at a 15 year low of 5.3%, while D grade continues its downward momentum representing just 4.2%. It is expected some further movement may occur across the quality grades as uncommitted premium space continues to be added to the market together with refurbished A grade space.

Internal, 230 Clarence 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 despite incentive rates remaining reasonably high. Over the last year, we have seen the prime face rent grow by 6.25% to now average $888/sqm, yet within the broad range of $700/sqm to over $1,000/sqm. The secondary market has not seen the same rapid increase in face rents albeit still moving in an upward direction growing by 2.50% to average $655/sqm. Incentives have shown some compression from their highs during 2013/2014 which ranged up to 35%, this fall to current prime low of 27% has improved the effective rental position also. With high supply of prime stock to likely to enter the market over the next couple of years, we expect this window of opportunity for face growth to close keeping rents at a stable level and some possible increases back in incentives particularly for premium properties in the higher price bracket.

Table of Leasing Transactions

Address	Area (sqm)	Lease Start Date	Lease Term	Gross Face Rent ($/sqm)	Tenant Name
13.01, 55 Clarence Street	446	Sep-16	5	$725	Local Government Procurement
10.1, 66 Hunter Street	230	May-16	5	$730	Rockpool
Level 4, 179 Elizabeth Street	674	Feb-16	5	$700	Complispace
8/61 York Street	207	Feb-16	3	$685	FooForce
4.01, 25 Lime Street	176	Jan-16	1	$760	1page.com
10.01, 45 Clarence Street	127	Dec-15	3	$645	Plus500AU
2.06, 68 York Street	236	Dec-15	4	$815	StrataAssociates
20.03, 25 Bligh Street	111	Dec-15	3	$880	Intalock
27.02, 19 Martin Place	242	Nov-15	5	$950	Adepta
Part Level 30, 264 George Street	266	Nov-15	3	$785	Eaton Capital Pty Ltd
2.02, 71 York Street	313	Nov-15	1.5	$809	Airtasker

Source: Ray White

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Research

_Know How

Research

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