

NORTH SYDNEY

STRATA OFFICE MARKET BRIEF NOVEMBER 2016

Highlights

North Sydney strata office sales totalled **\$86.9 million** in the 2016 financial year, **representing a 56.8% increase** over the 10 year average.

The bulk of sales in FY15-16 by value stemmed from the **North Sydney suburb – at 58.9%**, compared to 57.4% in FY14-15.

Average sale prices across North Sydney **rose 18.1%** year on year, while **rates per square metre rose 3.3%**.

New government reforms will create a significant impact on the management, sales process and development of strata buildings.



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Average office strata sale rates per sqm rose 3.3% over FY15-16 on the back of a more favourable economic climate. An overflow of demand from the Sydney CBD has encouraged investors to look to North Sydney, with a large number of suites selling across the year.

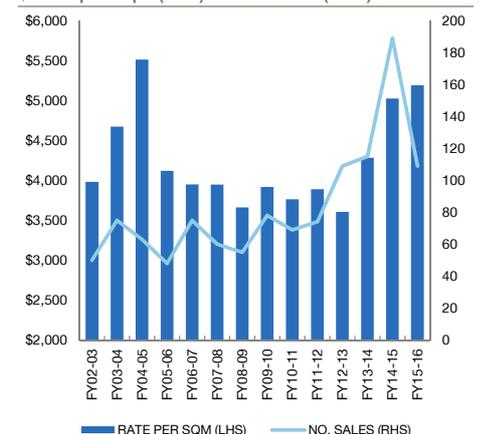
The strata office market conditions in the North Sydney Region (see back page for definition) in FY15-16 have continued a similar trend compared to FY14-15, recording substantially higher results than the historical average. Over the last year, historically low interest rates have sustained real estate demand from local investors, whilst the fall in the Australian dollar has continued to draw in foreign purchasers, particularly from Asia.

Coupled with a more favourable NSW economic climate, average strata sale prices in FY15-16 were recorded at \$797,402 – a significant rise of 18.1% from the prior year. In contrast, 109 sales were recorded for the year – 42.3% below the historical peak in FY14-15. Average rates per square metre also experienced growth of 3.3% (Figure 1) – trending above pre-GFC conditions – and have been recovering steadily since FY12-13. For this reason, many owners of commercial strata space are now choosing to divest their assets to capitalise on these gains.

Strata office vacancy rates in North Sydney suburb (as defined by PCA) currently measure 1.4% as at July 2016 – a substantial reduction of 300 bps year on year (210 bps reduction over the past six months) – with a smaller contraction of 100 bps experienced in the broader non-strata North Sydney CBD office market.

FIGURE 1
North Sydney Region Strata Annual Sales

\$ Rate per Sqm (LHS) and Number (RHS)



Source: Knight Frank Research, Cityscope

Approximately 4,836m² of strata office space was withdrawn from the North Sydney suburb over the year, stemming primarily from redevelopments.

Owner occupiers continue to dominate the strata market, with the cash rate 50 bps lower than 12 months ago (currently at 1.50%). Higher demand and pricing within the Sydney CBD has resulted in excess flow into the Sydney fringe, particularly the North Sydney market. With available credit relatively cheap and accessible, high demand has placed pressure on strata sale pricing.

Sales Activity by Precinct

The majority of buyer enquiry has again remained in the North Sydney suburb in FY15-16—an expected result due to the much larger strata office market size. By

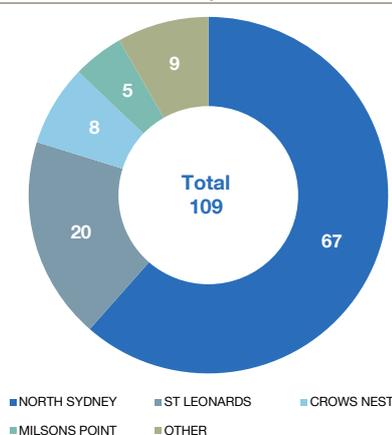
value, North Sydney suburb accounted for 58.9% of total sales, equivalent to \$51.2 million—an annual decrease of 30.1%. By number, North Sydney suburb decreased 33.0% year on year to record 67 sales. Despite the number of sales falling, the average sale price rose 4.4%, indicating higher quality assets transacted this year. The St Leonards suburb and Crows Nest suburb accounted for 18.1% and 10.1% of sales by value respectively. However, in FY14-15, 'Other' suburbs achieved greater sales volume by value than all suburbs except North Sydney—indicating a marginal shift to the St Leonards and Crows Nest suburbs in FY15-16.

Crows Nest suburb was recorded as having the highest average sale price at \$1,094,338, followed by waterfront Milsons Point (\$980,100) and St Leonards (\$785,225). However, the relatively small

amount of sales recorded in both Crows Nest (8) and Milsons Point (5) should be taken into consideration. North Sydney recorded an average sale price of \$764,435—substantially larger than its historical average of \$602,260.

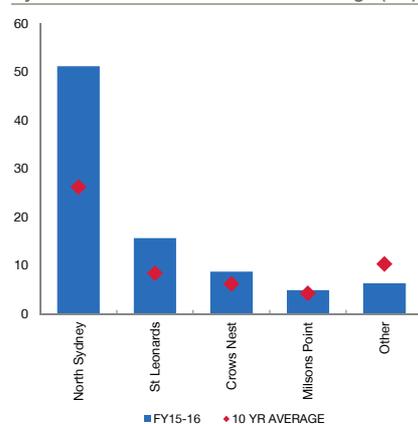
Sales volume by value for FY15-16 was recorded at \$86.9 million worth of transactions—far greater than the long-term average of \$55.4 million. The annual decrease in sales volume by value of 31.9% was largely underpinned with the previous financial year of achieving a historical high of \$127.9 million. North Sydney suburb experienced the largest fall in sales volume by value at 30.1% (to \$51,217,133) - albeit achieving almost double the historical average (Figure 3). The individual suburbs of Milsons Point and Crows Nest experienced annual growth in volumes by value of 15.9% and 6.2%. Conversely, 'Other' and St

FIGURE 2
FY15-16 Sales Volume by Number
Number of Transactions per CBD Precinct



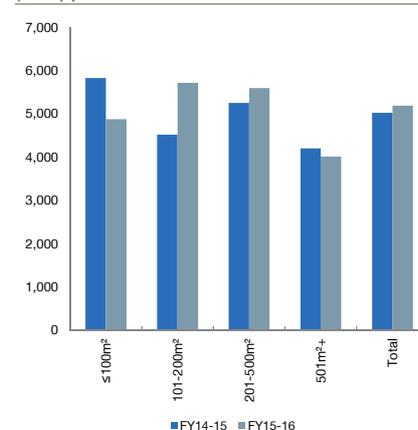
Source: Knight Frank Research, Cityscope

FIGURE 3
Annual Sales Volumes by Value
By Precinct—FY15-16 vs 10 Year Average (\$m)



Source: Knight Frank Research, Cityscope

FIGURE 4
Average \$/m² Value by Size Bracket
(\$/m²) per size Bracket



Source: Knight Frank Research, Cityscope

TABLE 1
North Sydney Region Strata Office Market Indicators—2016 Financial Year Data*

Precinct	Number of Transactions		Total Sales Volume by Value		Total Area of Sales (m ²)	Average Rate Per Square Metre [^]		Average Sale Price	
	(No.)	(%p.a.)	(\$m)	(%p.a.)		(\$/m ²)	(%p.a.)	(\$)	(%p.a.)
North Sydney Suburb	67	-33.0	51.2	-30.1	9,823	5,214	6.0	764,435	4.4
St Leonards	20	-54.5	15.7	-19.4	3,199	4,909	-1.4	785,225	77.2
Crows Nest	8	0.0	8.8	6.2	2,206	3,969	1.6	1,094,338	6.2
Milsons Point	5	0.0	4.9	15.9	621	7,891	76.2	980,100	15.9
Other	9	-71.9	6.3	-71.6	896	7,076	11.3	704,444	0.8
North Sydney Region#	109	-42.3	86.9	-31.9	16,745	5,191	3.3	797,402	18.1

Source: Knight Frank Research, Cityscope

* Figures subject to volatility as based on transactions only
Weighted average based on volume of transactions per precinct

[^] Transaction values adjusted to exclude car parking

Leonards experienced a fall in annual growth in volume by value at 71.6% and 19.4% respectively (Table 1). 'Other', St Leonards and North Sydney experienced decreases in the number of transactions at -71.9%, -54.5% and -33.0% respectively.

Rates Per Square Metre

The average rate per square metre achieved throughout FY15-16 measured \$5,191/m², an annual increase of 3.3%. The 101m²-200m² and 201m²-500m² size bracket suites both appreciated in value during FY15-16 at 26.5% and 6.5% respectively (Figure 4). Units less than 100m² in size depreciated 16.4% over the year, while units greater than 501m² also recorded a fall of 4.4% to \$4,015/m² in FY15-16—the lowest rate recorded among the size brackets. It should be noted however, that there is greater volatility in the 501m²+ bracket, with only five transactions recorded during the year.

The trend of smaller sized units achieving the highest rates per square metre does not hold true in FY15-16. Instead, it was the medium size brackets (101m²-200m² and 201m²-500m²) that achieved the largest annual growth while also recording the highest rates per square metre, at \$5,718/m² and \$5,596/m². The suburbs of Milsons Point and 'Other' experienced the largest growth in rates per square metre, at 76.2% and 11.3% (to \$7,891/m² and \$7,076/m²

respectively). However, only five transactions were recorded for the Milsons Point suburb, and nine were recorded in 'Other' suburbs.

Shore Financial purchased two floors at 153 Walker Street, North Sydney, totalling 700m² for \$3.03 million. The conglomerate consisted of multiple partners and brokers to achieve the highest on-market strata transaction recorded in more than a decade. Shore Financial had reportedly outgrown its prior office space at 83 Mount Street, and has since relocated to 153 Walker Street. The floors came with four car park spaces, and reflected a rate of \$3,986/m² (excluding parking).

Average Sale Size

The average FY15-16 strata sale price measured \$797,402 recording a substantial increase of 18.1% compared to FY14-15. The sale of 90-100 Mount Street, North Sydney, was excluded from Knight Frank's calculations, as the property was a significant anomaly. Purchased by DEXUS Property Group for \$41.0 million, including the one-off transaction substantially increased average sale price growth by 72.3% (to \$1,162,880), unreflective of the overall North Sydney market.

The suburbs of St Leonards and waterfront Milsons Point experienced the greatest annual average sale price growth, at 77.2% (skewed by five large strata sales) and 15.9% (to \$785,225 and \$980,100) respectively. Notable strata sales in the St Leonards suburb included 784m² at 67-69 Chandos Street (for \$6.3 million) and 767m² at 69 Christie Street (for \$3.9 million).

Crows Nest, North Sydney and 'Other' suburbs experienced annual growth rates of 6.2%, 4.4% and 0.8% respectively, to \$1,094,338, \$764,435 and \$704,444 respectively.

Strata size composition in FY15-16 was marginally greater in the 100m²+ category (Figure 5), at 50.5%, slightly less than the historical average (at 52.1%). This weighting is substantially lower than in FY07-08, where 70.0% of suites sold were 100m²+ in size. Sales composition was dissimilar to the prior financial year, where just 42.3% of strata office sales were suites larger than 100m² in size.

The number of sales for sub 100m² units fell by 50.5% compared to FY14-15, while total sales across all sizes decreased 42.3% year on year. Units greater than 100m² in size decreased by 31.3%, with five sales of 500m²+ recorded compared to just two in FY14-15.

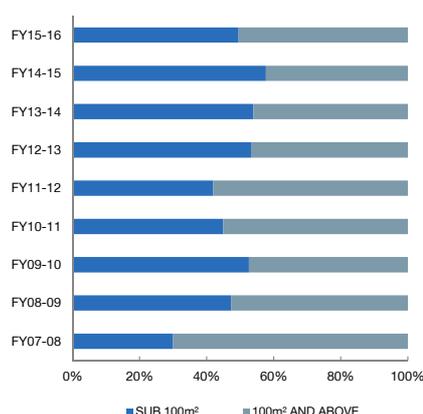
Many of the tenants displaced by the compulsory acquisitions of buildings for the new Metro station are now looking to purchase, due to the withdrawal of stock and subsequent reduction in vacancy rates. This is a flow on effect from tenants moving across the harbour to North Sydney from the CBD which has also experienced a tightening of vacancy rates. One such option for tenants and investors alike is a 115m² office suite at 122 Arthur Street, North Sydney (one of North Sydney's premium buildings).

New Supply

There is no new strata office space anticipated in the short term. The recent acquisition of 90-100 Mount Street by DEXUS Property Group (jointly with its wholesale fund) will see a new 34-storey premium office tower be developed on the site—with the net lettable area of the tower anticipated to reach 41,419m². The premium tower is expected to achieve a gross development value of \$467.5 million.

Nearby, Winten Property Group recently purchased the 'North Sydney Shopping World' (Berry Square) at 1 Denison Street,

FIGURE 5
Composition of Sales by Size
(%) of Transactions



Source: Knight Frank Research, Cityscope

Retail Sector

In FY15-16 the number of retail strata transactions measured 42, just 4.5% lower than the prior financial year. North Sydney suburb again recorded the largest number of transactions across the year, at 16 (up from six the prior year). No new retail supply was released onto the market.

Sales activity was varied across each suburb. The most expensive transaction was a 183m² unit on Military Road, Cremorne, sold to Beyond 2000 Investments Pty Ltd for \$3.7 million. In Crows Nest (164 Willoughby Road), a 401m² suite sold for \$2.7 million to Ocaga Holdings Pty Ltd. A 192m² suite at 155-157 Miller Street, North Sydney, sold for \$2.5 million to Transport for NSW, at a rate of \$13,250/m².



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as well as the adjoining office tower for an estimated \$80 million. The site holds development approval for a 30-storey mixed office and retail tower comprising of 53,800m². The large addition of office space (albeit not strata) is welcomed, as more than 50,000m² of office stock is expected to be withdrawn from the market from residential conversions in addition to the construction of the new metro station.

Reforms and Regulation

For years, strata ownership of office buildings has experienced multiple issues when faced with potential redevelopment, as well as the long-term maintenance of strata buildings due to multiple vested interests in a single building. In response, the NSW State Government has recently formalised a number of reforms to strata title in NSW which will have a major impact for both owners and developers. The most significant change of the Strata Schemes Management Act 2015 (coming into effect from 30 November 2016) is the 'Collective Sale and Renewal Reform' which allows strata schemes to be sold with an overall 75% consensus from owners—as opposed to the prior 100% consensus required. The reduced threshold means existing strata schemes are more easily sold, developed and potentially converted by both developers and investors.

These amendments have the potential to stimulate the rejuvenation of older strata buildings and provide greater opportunities

to create new, unexplored developments within North Sydney. However, it also increases the potential loss of strata supply through a more streamlined development process of existing buildings—as evident with the sale of 100 Mount Street, North Sydney.

Outlook

The North Sydney Region strata market is expected to continue the historically strong sales value trends over FY16-17. The compulsory acquisition of multiple towers to pave way for the new Victoria Cross Metro Station has displaced many tenants. As such, we expect continued strong sales and leasing activity as these tenants look for alternative options in the North Sydney region—coupled with a historically low interest rate and falling Australian dollar.

However, proposed changes outlined in the 2016 Federal Budget will impact the attractiveness of strata units from SMSF purchasers. Increases to tax on concessional super contributions as well as implementing a cap on transference of capital into a tax-free private pension will undoubtedly dampen the attractiveness of strata units to SMSFs.

The newly established 'Collective Sale and Renewal Reform' will ensure a simpler and more streamlined sales process for strata buildings. Whole strata buildings will more frequently be sold and developed with the consensus requirement dropping to 75%.

Note: The following report is written based on the North Sydney Region as defined by Cityscope—consisting of multiple suburbs. Unless otherwise specified, figures mentioned in this report refer to the combined figures of individual suburbs (including Cammeray, Cremorne, Crows Nest, Greenwich, Kirribilli, McMahons Point, Milsons Point, Naremburn, Neutral Bay, North Sydney, St Leonards, Waverton and Wollstonecraft) to form 'North Sydney' (region).

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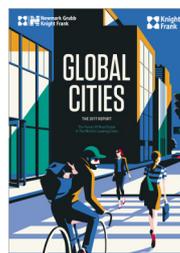
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