RESEARCH

SYDNEY CBD

RETAIL MARKET BRIEF JULY 2016

Key Facts

The vacancy rate in the Sydney CBD retail Core has compressed to 1.8%, down from 3.3% 12 months earlier.

3.6 million tourists visited NSW in the 12 months to March 2016 and their spend increased by a record 20% to $2.6 billion.

An influx of luxury and upmarket international retailers is boosting demand for prime sites in the CBD retail Core.

The Sydney CBD has experienced strong levels of investment over the past 12 months, with over $873 million worth of retail assets transacted.

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The vacancy rate in the Sydney CBD retail Core has tightened to 1.8% as at July 2016, underpinned by demand from upmarket international retailers. Retail conditions have been supported by the booming tourism sector in NSW.

Retail Overview

Australian retail conditions continue to mirror the country's multi-speed economy. Nationally, the latest ABS data in May 2016 shows retail sales grew by 3.4% yoy, slightly down from 3.5% in the prior corresponding period and 4.8% a year earlier. This represents a MAT (Moving Average Turnover) growth rate of 4.0% pa, below the 10 year trend growth rate of 4.5% pa.

In contrast, NSW remains the retail powerhouse of the country supported by a strong state economy, registering a retail MAT growth rate of 5.0%, significantly above the national average as well as the long-term growth rate. The favourable economic conditions in the State is further reflected in the positive performance of discretionary sales, growing at almost double the rate of non-discretionary sales.

Whilst the historic low interest rates and favourable exchange rates continue to support retail sales nationally, the strong housing activity and a booming tourism sector have been the key catalysts driving NSW retail performance. Despite some moderation recently, dwelling construction activity in the State remains above the long-term average, with high-density housing in Sydney being the driver of this growth. The number of international visitors to NSW, mostly from Mainland China, in the 12 months to March 2016 increased by 8.9% and visitor spend increased by a record 20%. NSW not only attracts more tourists but wealthier ones as well.

This strong inbound tourism has translated to positive trade conditions and leasing demand within the Sydney CBD, with international retailers intensifying the competition for prime locations. Whilst the market last year was dominated by fast-fashion brands, this year has seen an influx of luxury and upmarket international retailers securing sites in the CBD retail Core.

Knight Frank Research has completed its 2016 Sydney CBD Retail Core survey which highlights vacancy and tenancy mix trends across the precinct.

SYDNEY CBD RETAIL CORE SURVEY

Vacancy

The vacancy rate in the Sydney CBD retail Core has declined to 1.8% as at July 2016, from 3.3% 12 months earlier. The influx of international retailers amid limited availability of flagship sites has been the key driver of the decline in vacancy levels this year (Table 1). Consequently, street frontages experienced the tightest vacancy level as well as the largest yearly decline, with the vacancy rate contracting to 1.5% as at July 2016 from 3.5% a year earlier.

Among the major luxury flagship deals over the last 12 months are upmarket jeweller Cartier moving from MLC Centre to a triple-storey flagship store at 74 Castlereagh Street and Swiss watchmaker Franck Muller launching their first Sydney store at 147 King Street. The influx of luxury retailers is showing no sign of slowing this year with Chopard setting up a flagship store at the newly refurbished building at 119 King Street and upmarket jeweller Van Cleef & Arpels expected to open at 112 Castlereagh Street. Tiffany & Co is also eyeing an undisclosed location in the Retail Core for their relocation from 39 Martin Place, which will be acquired by the State Government for Sydney Metro construction.

TABLE 1
Sydney CBD Retail Core
Vacancy by retail type (%)

	Jul-15 (%)	Jul-16 (%)
Street Frontages	3.5	1.5
Arcades/Laneways	3.2	1.5
Shopping Centres	3.3	2.3
Total Retail Vacancy	**3.3**	**1.8**

Source: Knight Frank Research
*For definition of CBD Retail Core, see back page

The rejuvenation of the retail precinct at Martin Place has also been well received by international retailers with Swedish COS, an upscale sister brand of H&M, and Canadian apparel brand Kit & Ace taking up the ground floor at the former Commonwealth Bank Building at 5 Martin Place. At 20 Martin Place, American electric carmaker Tesla has just opened their first flagship showroom in Australia, which bears some resemblance to an Apple store.

In response to the increasing pressure from international players, a number of local retail chains have raised their game to remain in the City Core market. At the Mid City Centre, Australian-owned Mimco and Just Jeans have recently opened their flagship stores whilst Forever New and Sheike are also revamping their flagship stores. Cotton On Body and Typo, both owned by Melbourne-based Cotton On Group, are expanding at Westfield Sydney. These deals saw the Shopping Centre vacancy rate dip to 2.3% July 2016 from 3.3% in July 2015.

Arcade and Laneway shops have also experienced positive absorption, underpinned by new boutique brands and specialty food services. The QVB has attracted a cohort of new boutique international brands including Parisian shirt maker Anne Fontaine, Malaysia-based pewter manufacturer Royal Selangor and Japanese cosmetic chain Shu Uemura. New additions in The Galeries include healthy and alternative food offerings such as SumoSalad Green Label, Soul Origin and The Grounds in the City, a spinoff of The Grounds of Alexandria. Consequently, the vacancy rate for Arcades and Laneways has declined from 3.2% in July 2015 to 1.5% in July 2016.

Tenancy Mix & New Supply

Clothing, footwear & soft goods retailers continue to dominate the retail tenancy mix in the CBD, representing 39.5% of all shops within the CBD retail Core as at July 2016. Their market share has increased from 36.9% a year earlier. Female clothing remains the largest sub-category within clothing, but we have noticed an increase in Unisex clothing retailers over the last 12 months with the arrival of additional unisex brands such as Muji, COS and Kit & Ace.

The majority of clothing and footwear shops (51.1%) are located in shopping centres. Clothing and footwear retailers tend to congregate within an enclosed environment as shoppers prefer to browse around a variety of options before making their purchasing decision. This is in contrast to the luxury watch and jewellery retailers, who prefer standalone locations, particularly along Castlereagh Street and King Street.

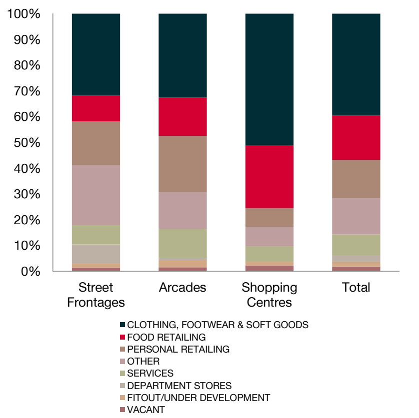
Food retailing is the second most popular retail category in the CBD with a market share of 17.2% as at July 2016. The majority of them are located in shopping centres (24%) and arcades (15%), in which they help to drive foot traffic into the centres. The number of gourmet and casual dining options focusing on providing the "experience" continue to rise across the CBD. Nevertheless, competition in this sector is extremely high and so is the churn rate compared to the other categories.

New supply of retail space is expected to come from a number of mixed-use developments in the CBD including Charter Hall's 333 George Street and Fife Capital's York & George. Construction at 333 George is approaching completion with two banks; NAB and HSBC, having already pre-committed to the retail podium. CBA is also moving to the newly developed 200 George Street (outside of our survey area). These deals, together with ANZ repositioning at 20 Martin Place, have highlighted the re-engagement of banks to prime retail sites in the CBD after being driven out by fashion brands in the past. This time, however, they are returning with a fresher look with their retail store concept featuring cutting-edge interactive and touchscreen technology, bigger and more open space for the customers.

FIGURE 1

Sydney CBD Prime Core Retail Tenancy Mix

% of number of shops by type

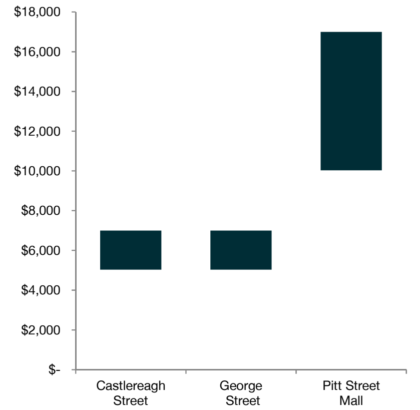


Source: Knight Frank Research

FIGURE 2

Sydney CBD Core Retail Rental Ranges by Type

$ per sq.m—Gross



Source: Knight Frank Research

Tenant Demand & Rents

Prime space within the CBD retail Core remains in high demand from international and local retailers. Coupled with a particularly tight vacancy rate, prime rents in the Sydney CBD retail Core have risen considerably over the past 12 months. Gross retail rentals in the Super Prime retail Core (encompassing Pitt Street Mall) now witness average prime rents between $10,000/m² and $17,000/m² — an increase of 8.0% over the past 12 months.

There are, however, some outliers with telco and technology brands willing to pay a premium over the average rents to secure sites in the fashion-centric Pitt Street Mall. The negotiation between Westfield and Vodafone saw Australia's third largest mobile carrier pay a new record rate per sqm for the small (101m²) site on ground floor as well as bear the price for being the only telco situated along Pitt Street Mall. Microsoft is also paying top dollar to secure the double-storey flagship site at the entrance of Westfield Sydney on Pitt Street Mall.

For premises outside Pitt Street Mall (George Street and Castlereagh Street precincts), gross rental rates currently average between $5,000/m² and $7,000/m² (see Figure 2) - an average increase of 9.1% over the past 12 months.

Most recently, 119 King Street, a particularly narrow building cornering Pitt Street Mall, has been leased to international luxury watch maker Chopard $500,000 p.a. for 210m² over five levels of retail space.

Investment Activity

The Sydney CBD has witnessed significant investment over the past 12 months with more than $873 million worth of retail assets transacted (Table 2). Most notable were the partial sales of Mid City Centre (75% to Hong Kong's Cheng Family by Fortius) and World Square (50% to ISPT by Brookfied) for $320 million and $285 million respectively— reflecting tight initial yields of sub-5%.

Mid City Centre, home to retailers including Japanese clothing label Uniqlo, British fitness club Virgin Active and Australian Rebel Sport, achieved a rate of $45,366/m². On the southern end of town, World Square, a primarily restaurant/food centric precinct, sold for $32,838/m².

A number of major retail assets in the retail Core are expected be transacted over the coming months. The sale of David Jones store on Market Street is close to completion, with Scentre Group reportedly being the frontrunner. Scentre's interest was anticipated, as its neighbouring Westfield Sydney is already linked to the Market Street site.

The Soul Pattinson Chemist site on 160 Pitt Street has also recently been put on the market for the first time in almost 150 years. Additionally, 119 King Street has also come to market for sale, with international luxury watch maker Chopard already secured as tenant. These deals will see the momentum in retail investment in the Sydney CBD be maintained over the next 12 months.

TABLE 2

Recent Sales Activity Sydney CBD Retail

Address	Price ($m)	Initial Yield (%)	GLAR (m²)	$/m² GLAR	Sale Date
Mid City Centre (75%)	$320.00	4.54	8,900	$47,942	May-16
King St Wharf (leasehold)	$90.00	6.00	5,653	$15,922	Feb-16
World Square (50%)	$285.00	4.42	16,936	$33,684	Dec-15
MetCentre (50%)	$159.00	5.48	6,582	$24,219	Dec-15
64 Castlereagh St (Bvlgari House)	$28.70	5.60	947	$30,327	Nov-15

TABLE 3

Recent Leasing Activity Sydney CBD Retail

Address	Tenant	Gross Rent* ($m, p.a.)	GLAR m²	Term yr	Lease Date
333 George St	HSBC	$2.55	685	Undisclosed	Q4-16
119 King St	Chopard	$0.50	210	7+7	Aug-16
112 Castlereagh St	Van Cleef & Arpels	$2.00	500	Undisclosed	Mid-16
Pitt St Mall (Westfield)	Vodafone	Undisclosed	101	Undisclosed	Dec-15
Pitt St Mall (Westfield)	Microsoft	Undisclosed	595	Undisclosed	Nov-15

Source: Knight Frank Research *Approx.

Outlook

The favourable trading conditions in the Sydney CBD retail Core are expected to continue over the next 12 months, underpinned by strong population growth in the Inner-City and an influx of wealthier visitors from Asia. This will lead to strengthening demand for prime sites in the CBD retail Core by both international and local retailers. Whilst leasing activity in 2014/15 was dominated by international fast-fashion retailers, 2015/16 has seen luxury and upmarket international retailers being in the driver seat. A number of local players have also upgraded their stores in the CBD Core.

Looking forward, we expect to see a re-engagement of banks in the CBD retail market after being driven out by fashion retailers in the past few years. This trend is evident by NAB and HSBC pre-committing to 333 George (following ANZ repositioning at 20 Martin Place) and at least six more major international banks searching for prime sites in the CBD.

In the food retailing sector, Woolworths has recently opened a convenience-style Metro store on York Street. This is Woolworth's smallest city store and mirrors the Metro concept popular in many global cities such as New York, London, Paris and Hong Kong. It is interesting to see whether this trend will catch on and how the other supermarket chains will respond in the coming months.

Despite some short-term impact on car traffic during the construction period, the delivery of the CBD Light Rail will certainly have a positive impact on retail trade in the Sydney retail Core over the long-term, particularly the areas along George Street.

The strong investment activity in Sydney is expected to continue with activity coming from the potential transactions of at least three major retail buildings in the retail Core over the next 12 months.

Retail Core Definitions:
Knight Frank's survey covers the key CBD retail precinct as defined as the Core. The CBD retail Core includes all retail premises within the broad boundaries of Martin Place to the North, Park Street to the South, Castlereagh Street to the East and George Street to the West. The Super Prime retail Core, home to the recent influx of international retailers encompasses the Pitt Street Mall.

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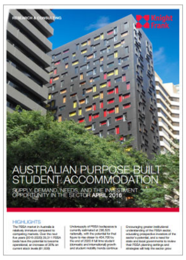

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