RESEARCH

APRIL 2012

SYDNEY CBD STRATA OFFICE

Market Overview

Knight Frank

Suite 3.05, 7 Bridge Street, Sydney
Owner: Amstal Properties Pty Ltd

HIGHLIGHTS

- 2011 has been a quiet year for the Sydney CBD Strata office market. With only \$93.673 million changing hands, this is down more than 40% on 2010 volumes. The capital values have also reduced, down from the peak 2005 result of \$6,118/m² by 18.1% to currently average \$5,008/m², a ten year low across the market.

- Some precincts have been affected more than others with the size and quality of sales completed the main catalyst for the volatility in average rates. The Core continues to be the most invested precinct followed by the Western Corridor averaging \$5,045/m² and \$4,702/m² respectively.

- Demand in the first quarter of 2012 has picked up with Self-Managed Super Funds being active in the \$500,000 to \$1 million price range. These investors are seeking quality in location and finish and could aid in the turnaround in the Sydney CBD Strata office market.

SYDNEY STRATA OFFICE OVERVIEW

Table 1
Sydney CBD Strata Office Market Indicators as at April 2012

Precinct	Number of Transactions	Total Volume of Sales ($ million)	Total Area of Sales (m^2)	Average Capital Value# ($/m^2$)	Average Annual Capital Value Change (%)	Average Sale Price#
Core	55	32.28	6,397	5,045	-13.19	586,835
Western Corridor	33	27.46	5,839	4,702	-1.49	831,988
Midtown	62	26.04	5,059	5,147	-11.49	420,019
Southern	9	5.05	1,090	4,637	-25.37	561,556
Waterfront	2	2.85	318	8,950	-7.82	1,423,000
Total	**161**	**93.68**	**18,703**	**5,008**	**-10.40**	**581,818**

Source: Knight Frank Research
weighted average based on volume of transactions per precinct

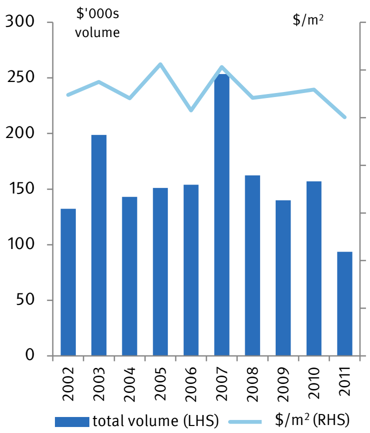
SALES ACTIVITY & CAPITAL VALUES

Sales Activity

Sales activity across the Sydney CBD Strata office market has shown a ten year low during the 2011 calendar year with total volumes unable to reach $100 million. A combination of limited supply in the market together with investor uncertainty surrounding the commercial market has resulted in the total volume falling by 40.4% compared to 2010. As a result we have also seen average capital values reduce, however this is a greater reflection on the limited quality stock available to the market.

Currently the average capital value achieved across the CBD market is $5,008/m² which is 10.40% down on 2010 results and the historical low for the last ten years. Strata has gone through two growth phases over this time, in the period after 2003 where investors looked for alternative investments during a time of high residential growth and again in late 2007 when total CBD vacancy fell dramatically to 3.7%. Looking alone at the total result shows how the addition of new projects across each of the CBD precincts over time has somewhat propped up the average whereas analysis on a precinct basis shows considerable volatility due to differing quality of stock.

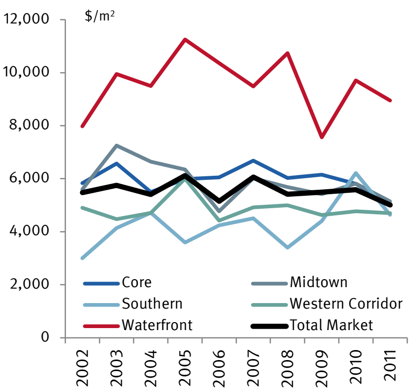
Figure 1
Sydney CBD Strata Turnover & Value
($) total market



Source: Knight Frank Research

The Core remains the precinct with the greatest level of investment and historically shown the most stability in values. The Western Corridor emerged as a growth region in 2007 for the broader office market as many larger tenants particularly from the banking and finance sector relocated. Capitalising on this renewal of the region, many refurbished strata buildings were supplied to the market having a strong growth affect with average prices reaching close to $5,000/m² and volumes accounting for more than 30% of the total strata market.

Figure 2
Sydney CBD Strata Capital Values
($/m²) by precinct



Source: Knight Frank Research

THE CORE... GREATEST LEVEL OF INVESTMENT

SUPPLY ACTIVITY & OUTLOOK

The Midtown witnessed a similar resurgence during 2007 as projects such as 250 Pitt Street together with other quality small suite offerings in the market achieved high values on the back of low vacancies and high rental growth prospects. The Southern precinct historically has limited turnover however demand for stock has always held high particularly in the Chinatown area by both owner occupiers and local investors.

Sale Size

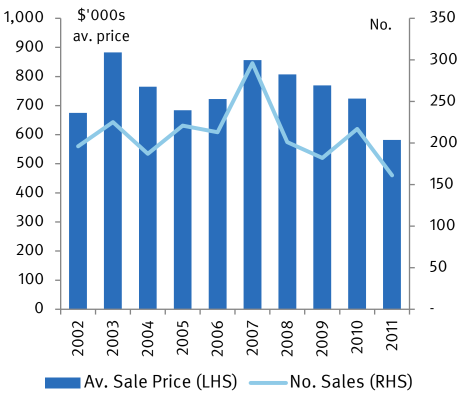
The average sale price during 2011 across all precincts was $581,000 this is the lowest recorded over the last ten years and 19.61% down from 2010 results. This fall in the average sale price was predominately due to the higher volume of the 0 to 100m² suites, which accounted for 66.5% of all sales compared to an average of 57.8% over the past five years.

2011 has seen the move away from the large suite sales with the purchaser profile showing an appetite for the smaller end of the size range or up to $1 million in value. Given the reduction in volumes, the number of sales has also fallen to a ten year low of just 161 sales.

Figure 3

Average Sale Price & No. Sales

($'000) Sydney CBD - Annually



Source: Knight Frank Research

New Supply

After the strong growth in supply and values for the CBD Strata market in the early 2000's new stock has trickled into the market in an irregular fashion. This has done much to manipulate the average capital values per precinct over the last ten years with new or refurbished stock demanding higher than average rates. Limited new stock brought to market last year aided in the lowered average rate, however 2012 brings the launch of a new Core offering; 350 George Street. This project is a five stage development which will offer refurbished office stock over the next five years; currently available on the market is two floors of 15m² to 67m² areas plus retail, with average rates ranging between $10,000/m² and $13,000/m².

Across the broader CBD office market, vacancy levels had compressed and now look to have stabilised. Due to the high incentive environment, some tenants have reassessed their options relocating to greater quality space resulting in the reduction to the Prime vacancy rate. This has resulted in some increase to vacancies recorded for B and C grade stock currently (January 2012) at 10.1% and 13.1% respectively. This highlights an opportunity for older strata assets to be refurbished collectively or be on sold for redevelopment. The dynamic of strata ownership does make this task difficult. However, given the supply of these quality assets are limited and demand is growing particularly by the Self-Managed Super Funds (SMSF) there may be a positive shift in capital values to entice developers.

Outlook

The Sydney CBD Strata Office market has gone through a bumpy ride for the last ten years with 2011 yielding the most challenging results. Limited transactional activity and dampened capital values suggest this may be the cyclical low for the Strata market. With new supply (albeit one project) in the market, this is the impetus needed to reinvigorate Sydney's CBD Strata market and bolster turnover levels and in turn grow capital values.

..THIS MAY BE THE CYCLICAL LOW FOR THE STRATA MARKET.

Looking to the total Sydney CBD market, the outlook for the next three years is positive. Limited net supply added to the market due to strong withdrawals has aided the anticipated weak white collar employment growth resulting in a reducing vacancy rate. While on the rental front, incentives are likely to reduce during 2013 and beyond resulting in stronger growth prospects for face rents. We have also witnessed an increased in investment activity for the first quarter of 2012 showing the improved accessibility to finance. These positives for the broader market translate to the strata market; smaller investors have acknowledged this improvement in investment fundamentals and look to capitalise on the current values.

SMSF's are one such investor, emerging as an active purchaser in commercial property since the change to government regulations allowing funds to borrow to invest in real estate. During the first quarter of 2012 Strata office has received an increased level of enquiry from this purchaser group most notably between $500,000 and $1 million price range. These savvy investors have identified this lull in the market and are actively pursuing assets with a strong focus on prime assets both in quality and location.

During difficulty in any market there is a flight to quality and this is no different in the strata office market. Recently refurbished properties will perform the best with an emphasis on the Core and Western Corridor precincts. Even smaller 50m² to 100m² assets are on the investment radar by these investors with quality being of paramount importance as to drive any future rental or capital value growth.

RESEARCH

Americas
USA
Bermuda
Brazil
Canada
Caribbean
Chile

Australasia
Australia
New Zealand

Europe
UK
Belgium
Czech Republic
France
Germany
Hungary
Ireland
Italy
Monaco
Poland
Portugal
Romania
Russia
Spain
The Netherlands
Ukraine

Africa
Botswana
Kenya
Malawi
Nigeria
South Africa
Tanzania
Uganda
Zambia
Zimbabwe

Asia
Cambodia
China
Hong Kong
India
Indonesia
Macau
Malaysia
Singapore
South Korea
Thailand
Vietnam

The Gulf
Bahrain
Abu Dhabi, UAE

Knight Frank Newmark Global

Knight Frank Research

Matt Whitby
National Director – Head of Research & Consultancy
+61 2 9036 6616
Matt.Whitby@au.knightfrank.com

Vanessa Rader
Director – Consulting & Research Services
+61 2 9036 6715
Vanessa.Rader@au.knightfrank.com

Nick Hoskins
Research Manager - NSW
+61 2 9036 6766
Nick.Hoskins@au.knightfrank.com

Commercial Agency Contacts

John Bowie Wilson
Director City Sales
+61 2 9036 6743
John.BowieWilson@au.knightfrank.com

Andrew Palmer
Executive Commercial Sales
+61 2 9036 6646
Andrew.Palmer@au.knightfrank.com

Knight Frank Research provide strategic advice, consultancy services and forecasting to a wide range of clients worldwide including developers, investors, financial and corporate institutions. All recognise the need for the provision of expert independent advice customised to their specific needs.

Knight Frank Research reports are also available at www.knightfrank.com.au