RESEARCH

SYDNEY CBD

STRATA OFFICE MARKET BRIEF MAY 2015

Highlights

Sydney CBD strata office sales totalled **$121.0 million** in the 2014 calendar year, **representing a 0.7% decrease** over 2013.

The bulk of sales of 2014 came from the **Midtown precinct—at 40.4%,** compared to 27.9% in 2013.

SMSFs and offshore investors continue to invest in the strata market, albeit superannuation changes are mooted in the May Budget.

Proposed government reform will influence the way strata buildings are managed, sold and developed.

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In spite of a more favourable economic climate, average strata sale prices by value in 2014 rose by only 3.1% compared to the 2013 calendar year. With the proposed NSW Government strata reforms, there is potential for greater activity occurring in the strata market.

The strata office market trends in 2014 have remained somewhat similar to the results in 2013. Over the last year, historically low interest rates have sustained property demand—especially residential— for local investors, whilst the fall in the Australian dollar has continued to draw in foreign purchasers, particularly from Asia.

In spite of a more favourable economic climate, average strata sale prices in 2014 were recorded at $661,173 —only a slight rise of 3.1% from the previous year. In contrast, 183 sales were recorded for the year—38.2% below the peak in 2007. Conditions faced in the strata market are trending below pre-GFC conditions—however are recovering steadily since the trough of 2011 (Figure 1).

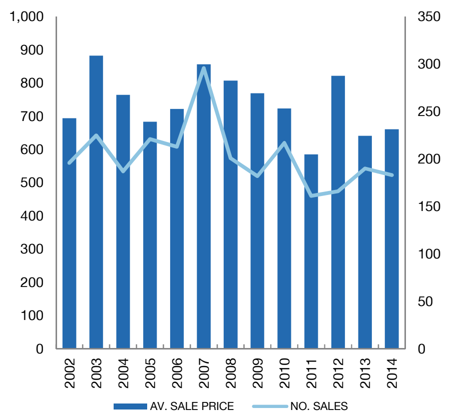
With available credit relatively cheap and accessible, owner occupiers have relocated from Sydney's fringe into the CBD. This has driven demand for the strata market, because of the capital value upside in the long-term as well as a historically low interest rate—conditions which especially benefit SMSFs and owner occupiers alike.

The NSW Government is in the process of formalising a number of reforms to strata title which will influence the way strata buildings are managed, sold and developed.

FIGURE 1

Sydney CBD Strata Annual Sales

$ Million Value (LHS) and Number (RHS)



Source: Cityscope, Knight Frank

Sales Activity by Precinct

The majority of buyer enquiry has shifted from the Core precinct in 2013, to the Midtown precinct in 2014. By value, Midtown accounted for 31.8% of total sales, equivalent to $38.4 million. By number, Midtown increased a substantial 39.6% from the 2013 level to measure 74 sales.

The Core and Western Corridor precincts accounted for 38.4% and 24.9% of sales by value respectively. In 2013, the Core achieved greater sales than that of Midtown—indicating a marginal shift in buyer demand throughout the precincts. The Western Corridor was recorded as the highest average sale price at $1,074,950, followed by Waterfront at $942,500. It should be noted, however, that the Waterfront's 10 year average is substantially higher than that of Western Corridor's—at $1,358,273 and $908,404 respectively.

Sales volume by value for 2014 was comparatively low, with every sector falling below their 10 year average (Figure 3). However, Midtown and Western Corridor were the only precincts to achieve higher volumes by number than 2013—with Midtown increasing by a substantial 39.6%, partly due to a combined 20 units selling across 147A King St and 250 Pitt St.

Rates Per Square Metre

The average rate per square metre achieved throughout 2014 measured $5,280/m², an annual decrease of 6.9%. All size brackets except the large suites of 201m²-500m² depreciated in 2014 (Figure 4). However, units greater than 501m² recorded a substantial fall from $4,448/m² in 2013 to $3,264/m² in 2014—a depreciation of 26.6%.

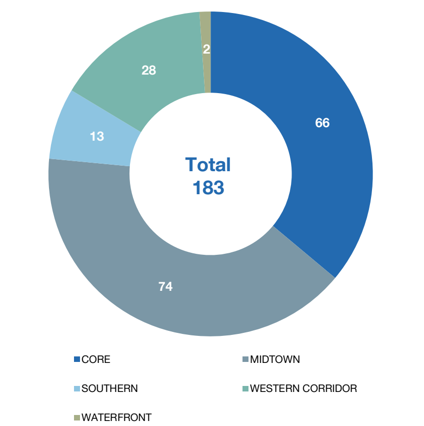
The trend of smaller unit areas achieving higher rates per square metre still holds true in 2014. The rate for sub-50m² strata sales reflects a substantial 97% premium in price when compared against strata sales in excess of 500m².

The number of sales for sub 100m² units fell by 9.8% compared to 2013. However, units greater than 100m² in size increased by 7.4%, indicating a shift in unit size demand between the CBD strata office

FIGURE 2

2014 Sales Volume by Number

Number of Transactions per CBD Precinct

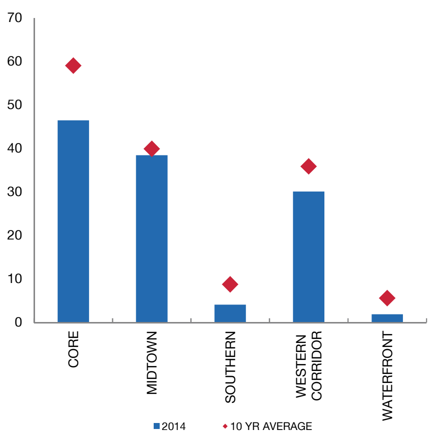


Source: Cityscope, Knight Frank

FIGURE 3

Annual Sales Volumes by Value

By Precinct—2014 vs 10 Year Average ($m)

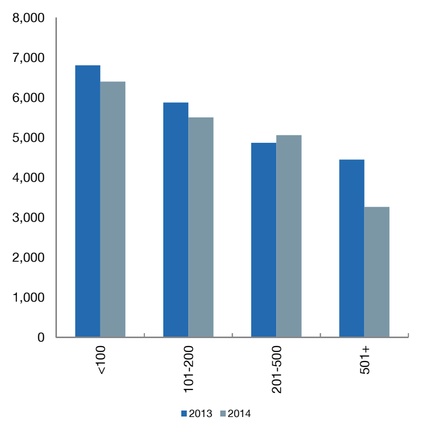


Source: Cityscope, Knight Frank

FIGURE 4

Average $/m² Value by Size Bracket

($/m²) per size Bracket



Source: Cityscope, Knight Frank

TABLE 1

Sydney CBD Strata Office Market Indicators—2014 Calendar Year Data*

Precinct	Number of Transactions		Total Sales Volume by Value		Total Area of Sales	Average Rate Per Square Metre^		Average Sale Price	
	(No.)	(%p.a.)	($m)	(%p.a.)	(m²)	($/m²)	(%p.a.)	($)	(%p.a.)
Core	66	-10.8	46.5	-0.9	8,584	5,416	-16.7	704,347	11.1
Midtown	74	39.6	38.4	23.1	6,857	5,604	8.4	519,285	-11.9
Southern	13	-56.7	4.1	-66.9	852	4,809	-6.6	315,154	-23.7
Western Corridor	28	16.7	30.1	38.6	6,395	4,707	0.2	1,074,950	18.8
Waterfront	2	-77.8	1.9	-80.4	228	8,268	5.0	942,500	-11.8
Total#	**183**	**-3.7**	**121.0**	**-0.7**	**22,916**	**5,280**	**-6.9**	**661,173**	**3.1**

Source: Cityscope, Knight Frank

* 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 size brackets.

The Sydney residential market has been running especially hot in recent years, and the conversion of buildings into residential towers has seemingly been the highest and best use compared to the existing use of commercial or retail. Thus, demand for strata units has been comparatively falling due to more attractive returns found in the market—decreasing the rates per square metre achievable and limiting development in the strata market.

Coined as potentially one of the largest strata sales of 2015, all 17 storeys of 131 Macquarie St (Hudson House) are poised to come to market in 2015—as a residential site. DA approvals have been sought for multiple levels for residential conversion—once again cementing the theme of significant returns gained from the current residential market. Strata conversion trends are set to continue due to forthcoming proposed strata reform.

Average Sale Size

The average 2014 strata sale price was $661,173, recording an increase of 3.1% compared to 2013. Not all precincts experienced this increase—Midtown, Southern and Waterfront average sale prices fell by 11.9%, 23.7% and 11.8% respectively.

The Western Corridor experienced a substantial 18.8% rise in average sale price, however these figures were predominantly driven by high-priced units including 37 York St at $3.5 million and 263 Clarence St at $3.3 million.

The results across all precincts, however, reflected relatively stronger sales activity amongst smaller strata suite areas. Sales of suites less than 100m² accounted for 60.1% of total sales. Although this is reasonably in line with the historical norm, it was a marked increase from the relatively low 47.6% recorded in 2012 (Figure 5).

Demand has been driven by owner occupiers and SMSFs, due to the capital upside in the long-term and relatively cheap and available credit. The nature of SMSFs mean their enquiries are predominantly confined to sub $1 million opportunities, thus attracting this buyer type to smaller strata suites.

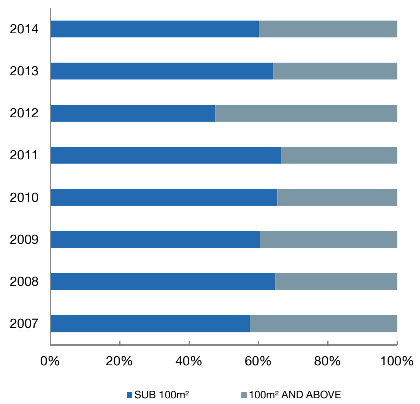
However, with the upcoming 2015-2016 Federal Budget to be delivered in May, there exist potential alterations made to the structure of superannuation—with both parties endorsing modifications. Specifically, the mooted changes to concessions have the potential to make the purchasing of strata units less attractive for SMSFs, due to the potential increase in contributions tax from 15% to 30% as well as tax threshold revisions.

New Supply

Since the mid-2013 strata subdivision of 350 George Street, there has been no new supply for the CBD in 2014 and none slated for 2015. The tightening of the strata office supply is due to residential land prices skyrocketing in the Sydney CBD, as developers mostly desire whole buildings for residential conversion. Office strata suites remain at relatively unchanged price points as development is less feasible than larger commercial development or residential conversion.

However, with the proposed NSW Government Strata reforms, there is potential for greater opportunities for new strata development and renewal.

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



Source: Cityscope, Knight Frank

Retail Sector

In 2014 retail strata supply was limited, with no new units released onto the market. This lack of supply was evidenced with only two units sold on George Street, one of the major retail streets within the Sydney CBD. However, there remained very strong demand for prime retail strata space within the CBD, underpinned by overseas buyers.

Renowned retail areas Martin Place and Pitt Street saw a high level of sales activity with high profile tenants in place.

An 877m² unit at 72-72A Castlereagh Street, the Trust Building, was sold for $9.9million in 2014. Sold to local purchasers, the unit was recorded as the largest and most expensive retail unit to come to market for the year.

Pitt Street alone accounted for 19% of the value of retail strata sales in 2014, the largest of which was Unit 14 in 250 Pitt Street, that sold for $3.1 million at a rate of $27,434 per square metre.

53 Martin Place was sold for $8 million at a rate of $30,303 per square metre with the prestigious Lindt Chocolate Café as the tenant.

Asian investors entering the Sydney market are actively seeking retail opportunities—with 80% of Knight Frank's retail transactions in 2014 being purchased by Hong Kong investors. However, the relatively low transaction volumes in this sector has ensured yields tighten, with suites generally selling in a yield range of between 4.5% and 5.0%.

Prime retail suites continue to experience aggressive capital pursuing the rare opportunities, for example 653 George St in Chinatown having achieved a high sale price of $70,000/m².

With only 38 retail strata units selling in 2014, the consequence of the tight retail strata market and the high demand has seen rates push higher, in some cases up to 100,000/m².

There is currently no new supply slated for 2015.

Community Schemes Law Reform

Strata ownership of office buildings has become an issue within Sydney's CBD. There has been difficulty in amalgamating strata units for redevelopment and concerns exist regarding the long-term maintenance of strata buildings due to multiple owner interests.

The NSW State Government is in the process of formalising a number of reforms to strata title in NSW which, when implemented, will have a major impact for both owners and developers.

The most significant change of the reform (titled Community Schemes Law Reform) involves allowing strata schemes to be terminated with an overall 75% consensus from owners—as opposed to the current 100% consensus required. The reduced threshold means existing strata schemes will more easily be 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 developments within the CBD. However, it also increases the potential loss of strata supply through a more streamlined development process of existing buildings—developments which may be converted to alternate use over time.

Outlook

The CBD strata market is expected to continue the trends experienced in 2014 into 2015. Sales value and sales volume remain below pre-GFC conditions, as well as below ten year averages—allowing room for recovery within the strata market.

The falling Australian dollar will ensure foreign investors, primarily from Asia, will continue to invest heavily throughout Sydney across all property sectors.

With residential development and prices continuing to boom, and interest rates expected to remain lower for longer, demand for large strata units may be tapered as investors seek greater capital returns from the residential market. Non-strata whole office buildings will continue to achieve greater demand than strata suites, where residential conversion currently remains difficult to attain.

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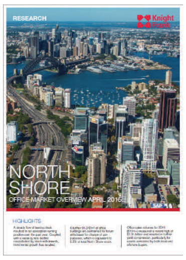

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