RESEARCH

SYDNEY CBD

STRATA OFFICE MARKET BRIEF **SEPTEMBER 2016**

Highlights

Sydney CBD strata office sales totalled **$231.0 million** in the 2016 financial year, **representing a 54.2% increase** over the 2015 financial year.

The bulk of sales volume in FY15-16 stemmed from the **Core precinct—at 39.3%,** compared to 30.0% in FY14-15.

Significant retail strata assets have sold over the past 12 months, garnering significant interest from foreign investors.

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

BRADLEY REHN

Analyst

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A more favourable economic climate in FY15-16 has seen average office strata sale rates per sqm rise by 13.4%. A plethora of new reforms and regulations recently introduced will impact the sale, development and management of future strata sales.

The strata office market trends in FY15-16 have significantly improved compared to FY14-15, as well as the long-term 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.

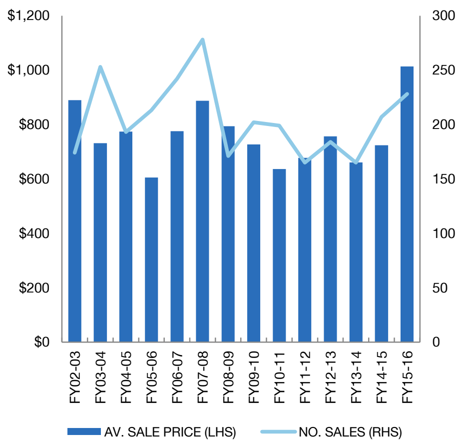
Coupled with a more favourable economic climate, average strata sale prices in FY15-16 were recorded at $1,013,307 —a significant rise of 40.0% from the prior year. In contrast, 228 sales were recorded for the year—18.0% below the peak in FY07-08. Only 78 sales were recorded for the first half of 2016, a substantial 27.1% smaller figure than the first half of 2015. Average prices in the strata market are trending above pre-GFC conditions—and have been recovering steadily since FY13-14 (Figure 1). Strata office vacancy rates currently measure 4.8% as at July 2016—a reduction of 20 bps year on year—with similar contractions experienced in the combined strata and non -strata Sydney CBD office market.

Owner occupiers continue to dominate the strata market, with the cash rate 50 bps lower than 12 months ago (currently at 1.50%). Only 18 months ago, owner occupiers were relocating from the Sydney fringe into the CBD. However, higher demand and pricing has resulted in excess

FIGURE 1

Sydney CBD Strata Annual Sales

$ Million Value (LHS) and Number (RHS)



Source: Knight Frank Research, Cityscope flow into the Sydney fringe, particularly the North Sydney market. With available credit relatively cheap and accessible, high demand has put pressure on strata sales, with new records broken for sale prices. Strata units continue to be tightly held, and thus high quality strata assets attract significant demand when placed on the market.

Sales Activity by Precinct

The majority of buyer enquiry has shifted from the Midtown precinct in FY14-15, to the Core precinct in FY15-16. By value, Core accounted for 39.3% of total sales, equivalent to $90.8 million. By number, Core increased only 9.6% year on year to record 80 sales, indicating the average sale price was far greater this year. The Western Corridor and Midtown precincts accounted for 30.0% and 18.7% of sales by value respectively. In FY14-15, Midtown achieved greater sales than that of Western Corridor—indicating a marginal shift in buyer demand throughout the precincts.

The Western Corridor was again recorded as the highest average sale price at $1,214,449, closely followed by Southern ($1,155,500), Core ($1,135,569) and Waterfront ($1,128,333). It should be noted, however, that the Waterfront's 10 year average is substantially higher than that of Western Corridor's—at $1,278,501 and $978,379 respectively.

Sales volume by value for FY15-16 was comparatively high, with every sector except Waterfront recording above their 10 year average (Figure 3). However, Midtown was the only precinct to achieve lower volumes by number than FY14-15, decreasing by a substantial 19.3% to 67 sales (albeit Waterfront recorded 3 sales in FY15-16 as opposed to 4 sales in FY14-15).

Rates Per Square Metre

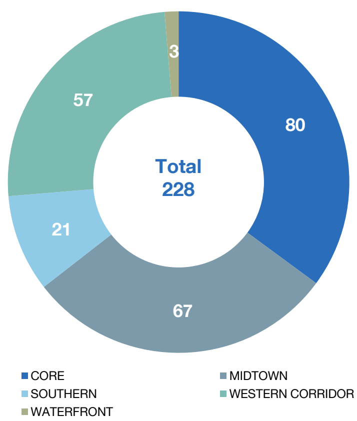
The average rate per square metre achieved throughout FY15-16 measured $6,725/m², an annual increase of 13.4%. All size brackets except the mid-sized suites of 101m²-200m² appreciated in FY15-16 (Figure 4). Units greater than 501m² recorded a substantial rise of 47.5% to $7,007/m² in FY15-16.

The trend of smaller unit areas achieving the highest rates per square metre still holds true in FY15-16. The lowest rate

FIGURE 2

FY15-16 Sales Volume by Number

Number of Transactions per CBD Precinct

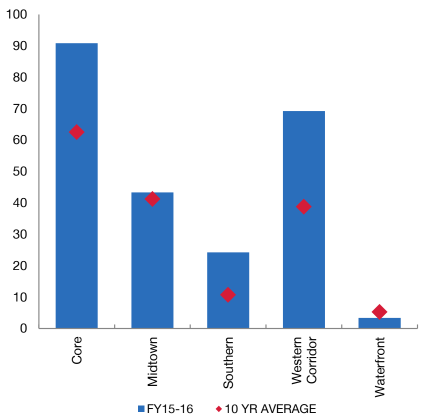


Source: Knight Frank Research, Cityscope

FIGURE 3

Annual Sales Volumes by Value

By Precinct—FY15-16 vs 10 Year Average ($m)

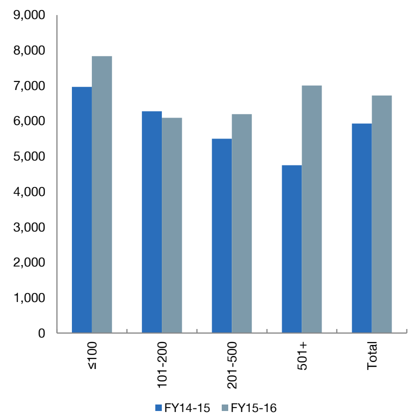


Source: Knight Frank Research, Cityscope

FIGURE 4

Average $/m² Value by Size Bracket

($/m²) per size Bracket



Source: Knight Frank Research, Cityscope

TABLE 1

Sydney CBD Strata Office Market Indicators—2016 Financial 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	80	9.6	90.8	102.2	12,084	7,518	10.3	1,135,569	84.5
Midtown	67	-19.3	43.3	-24.8	6,458	6,707	13.7	646,484	-6.9
Southern	21	61.5	24.3	354.8	3,695	6,567	15.6	1,155,500	181.6
Western Corridor	57	67.6	69.2	82.9	11,659	5,937	16.6	1,214,449	9.1
Waterfront	3	-25.0	3.4	-16.7	456	7,423	-3.7	1,128,333	11.1
Total#	**228**	**10.1**	**231.0**	**54.2**	**34,352**	**6,725**	**13.4**	**1,013,307**	**40.0**

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 per square metre was achieved in the $101m^2$-$200m^2$ size bracket. Comparatively, the rate for sub-$50m^2$ strata sales reflects a substantial 30.1% premium in price when compared against strata sales between $101m^2$ and $200m^2$ in size.

Over the course of four months, six levels of 261 George St were sold to separate purchasers by vendor Kingsmede Pty Ltd (once owner of the entire building). Each floorplate was approximately $336m^2$ in size and ranged in sale value from $2.3 million to $2.7 million. The purchasers were primarily local private investors.

Average Sale Size

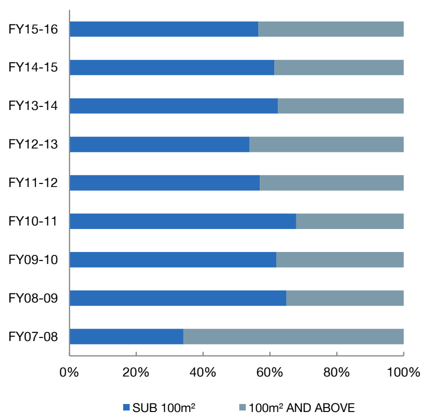
The average FY15-16 strata sale price was $1,013,307 recording a substantial increase of 40.0% compared to FY14-15. The significant growth was largely influenced by a strong growth in average sale price in both the Southern and Core precincts, at 181.6% and 84.5% respectively. Midtown, Western Corridor and Waterfront precincts experienced growths of –6.9%, 9.1% and 11.1% respectively.

The Southern precinct experienced a substantial 181.6% rise in average sale price, however these figures were predominantly driven by the sale of three high-priced transactions at 8 Quay St, 451 Pitt St and 25 Dixon St at a combined total of $15.9 million.

The bulk of strata sales activity in FY15-16 were suites smaller than $100m^2$ in size (Figure 5). Sales of suites less than $100m^2$ accounted for 56.6% of total sales, slightly less than the historical average (at 57.8%). Sales composition was similar to the prior financial year, where just 61.4% of strata office sales were suites less than $100m^2$ in size.

The number of sales for sub $100m^2$ units increased by 15.7% compared to FY14-15, while total sale across all sizes increased only 10.1% year on year. Units greater than $100m^2$ in size increased by 23.8%, with 13 sales of $500m^2$+ recorded compared to just five in FY14-15.

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



Source: Knight Frank Research, Cityscope

New Supply

Since the mid-2013 strata subdivision of 350 George St, there has been no new strata supply for the CBD and none slated for FY16-17. However, with the recently introduced 'Collective Sale and Renewal Reform' to strata properties, it is very likely that new strata development will increase in the future. Developers naturally have a stronger appetite for whole commercial towers, and the newly introduced legislation ensures a much easier process in acquiring entire strata buildings as opposed to a select number of floors.

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

Retail Sector

In FY15-16 the number of retail strata transactions measured 36, just 5.3% lower than the prior financial year. No new supply was released onto the market. This lack of supply was evidenced with only one unit sold on George St, one of the major retail streets within the Sydney CBD.

Sales activity in prestigious Martin Place and Pitt St was also relatively subdued in FY15-16, with four suites sold on Pitt St for a total of $3.5 million. A $40m^2$ suite at 109 Hunter St (Hunter Connection) sold for $1.0 million to achieve a substantial rate of $25,875/m^2$.

However, there remained very strong demand for prime retail strata space within the CBD, underpinned by overseas buyers.

One of the most significant strata sales in FY15-16 was the prestigious 'Castlereagh Chambers' (Bvlgari House) at 64 Castlereagh St. The sale, comprising of several strata units, measured just $667m^2$ in size and recorded a substantial sale price of $28.7 million—equal to $43,071/m^2$. The property was purchased from Aviva Asia Pacific Property Fund by Allegra European Holdings, a Spanish real estate company. This was Allegra's first acquisition in the Australian market.

The most recent significant retail strata acquisition was the sale of Neil Perry's fine dining Rockpool premises at 66 Hunter St. Purchased in July 2016, the $2,000m^2$ ground and basement floor was secured once again by Spanish real estate company Allegra European Holdings, paying almost $30 million for the two levels.

Knight Frank Australia has recently been appointed to sell an eight lot, four level strata title property at 1 Dixon St, Sydney. Regarded as the 'gateway' of Chinatown and bound by Dixon, Goulburn, Liverpool and Harbour streets, the property currently houses five tenancies that total $2,534m^2$ in size with a large 32 metre street frontage to Dixon St. The property neighbours the Chinese Garden of Friendship, and is just minutes walk from the $3.4 billion, 20 hectare Darling Harbour Live project. Tenancies include two restaurants, one restaurant and bar, one internet and gaming café and one karaoke bar.

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 the CBD, including aggregates of adjoining sites. 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.

The City of Sydney has recently endorsed significant changes to planning controls within the Sydney CBD. The 'Central Sydney Planning Strategy' alters current planning controls to 'unlock' up to 2.9 million square metres of new floor space, while also capping residential components to 50% on certain developments. The strategy, coupled with an easier sale and development process for strata buildings, will likely see new opportunities for strata buildings to be purchased outright by a single buyer and developed into new mixed office and residential towers, in order to diversify risk.

The 2016 Federal Budget delivered in May by Treasurer The Hon Scott Morrison MP saw many proposed changes to the structure of Self-Managed Super Funds (SMSFs)—specifically impacting high income earners. In particular, from July 2017 superannuants over the age of 65 will be limited to transferring a maximum of $1.6 million into a tax-free private pension—where currently there exists no limit. An increase in tax on concessional super contributions from 15.0% to 30.0% will also be enforced to those earning over $250,000. Many of these proposed changes must be passed in parliament to take effect, however both major political parties have been vocal in support of amendments.

Outlook

The CBD strata market is expected to continue the comparatively strong sales value trends over FY16-17, however at a reduced volume. With significant strata assets trading over FY15-16, it is unlikely equally large activity will be experienced in the short-term.

The historically low interest rates coupled with a falling Australian dollar will ensure both local and foreign investors, primarily from Asia, continue to invest heavily throughout Sydney across all property sectors, in particular high quality office and retail units.

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%.

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.

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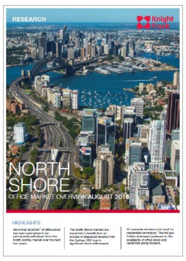

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RESEARCH
Bradley Rehn
Analyst
+61 2 9036 6656
Bradley.rehn@au.knightfrank.com

Matt Whitby
Group Director
Head of Research and Consultancy
+61 2 9036 6616
Matt.whitby@au.knightfrank.com

CAPITAL MARKETS
John Bowie Wilson
Head of Commercial Sales, NSW
+61 2 9036 6743
John.bowiewilson@au.knightfrank.com

Dominic Ong
Senior Director, Asian Markets
+61 2 9036 6747
Dominic.ong@au.knightfrank.com

Andy Hu
Director, Asian Markets
+61 2 9036 6613
Andy.hu@au.knightfrank.com

Jonathan Vaughan
Associate Director
+61 2 9036 6729
Jonathan.vaughan@au.knightfrank.com

Fiona Cutler
Sales Executive, North Sydney
+61 2 9028 1107
Fiona.cutler@au.knightfrank.com

Daniel Francis
Analyst
+61 2 9036 6826
Daniel.francis@au.knightfrank.com

VALUATIONS
David Castles
National Director
+61 2 9036 6648
David.castles@au.knightfrank.com

NSW
Richard Horne
Managing Director, NSW
+61 2 9036 6622
Richard.horne@au.knightfrank.com

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