RESEARCH

SYDNEY CBD
RETAIL MARKET BRIEF JULY 2017

Key Facts

The vacancy rate in the Sydney CBD retail Core has increased to 2.6%, up from 1.8% 12 months prior.

Increased competition among retailers has seen a number of retailers cease operations in the past 12 months.

Clothing, footwear and soft goods continue to dominate the tenancy mix in the CBD representing 39.1% of all tenants.

A decline in consumer sentiment has been experienced in the past 12 months, with the discretionary spending growth rate falling from 5.1% to 3.1%.

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A slight increase in the vacancy rate over the past year presents an opportunity for new retail tenants to enter the market and allow existing tenants to expand their operations.

Retail Overview

Australian retail conditions have remained challenging in the past 12 months, underpinned by fairly pessimistic consumer confidence and concerns over declining housing affordability. The Westpac Melbourne Institute's Consumer Sentiment Index fell 5.9% in the 12 months to June 2017. In conjunction with concerns of rising interest rates, the "Time to buy a dwelling" index fell to its lowest level since 2010. These conditions were reflected in the latest ABS data in May 2017, which saw retail sales growth in Australia at 3.7% YoY, moderately down from 3.8% in the previous corresponding period.

Historically, NSW has been the strongest state by retail turnover according to the ABS. However, amidst economic uncertainty and low consumer sentiment, the NSW annual turnover growth rate currently sits at 3.5%, significantly lower than the 10 year average of 4.5%. Additionally, the discretionary retailing turnover growth rate has fallen from 5.1% to 3.1% in the 12 months to May 2017, reflective of consumers current conservative buying patterns.

Increased competition between international retailers and luxury brands, all aiming to have a dominant footprint on the Australian retail market, continues to drive competition in the market and in turn have negative implications for some retailers, forcing them to cease trading. Additionally, the construction of the new Sydney Light Rail network is causing short term disruptions for retailers along George Street. However, the long term outlook is positive with the retail strip set to be rejuvenated upon its completion by 2020.

The rise in vacancy levels presents an opportunity for existing tenants to expand their operations or new retailers to enter the market. The tenant movement and activity in the coming 12 months will provide a stronger indication of the strength of the retail market and the preference of tenure that property owners are seeking.

Knight Frank Research has completed its 2017 Sydney CBD Retail Core survey which highlights vacancy and tenancy mix trends across the precinct.

SYDNEY CBD RETAIL CORE SURVEY

Vacancy

The current economic conditions and low consumer confidence levels have seen vacancy levels in the Sydney Prime CBD retail core rise in the 12 months to July 2017, increasing from 1.8% to 2.6%. Underpinned by strong competition in the market from large international retailers and the continuing growth in E-Commerce trade, well known brands including Topshop, Kit & Ace, Payless Shoes, Rhodes & Beckett, Herringbone, Marcs, David Lawrence and non fashion retailers including Dick Smith have ceased operations or entered into administration.

Shopping centre vacancy levels remained steady at 2.3% in the 12 months to July 2017. The most notable movements include Tiffany & Co occupying space in Westfield, in addition to the luxury jeweller developing its new flagship store at 175 Pitt Street, along with Swarovski moving into the ex Lovisa space in MidCity Centre.

TABLE 1

Sydney CBD Retail Core

Vacancy by retail type (%)

	July 2015	July 2016	July 2017
Street Frontages	3.5%	1.5%	3.1%
Arcades/Laneways	3.2%	1.5%	2.6%
Shopping Centres	3.3%	2.3%	2.3%
Total Retail Vacancy	**3.3%**	**1.8%**	**2.6%**

Source: Knight Frank Research

*For definition of CBD Retail Core, see back page

Despite a steep decline in vacancy levels in July 2016 down to 1.5%, street frontages vacancy has risen significantly to 3.1% as at July 2017. Park and Pitt Street experienced significant increases in vacancy levels to record 6.6% and 7.6% respectively. Notable vacancies include Roxy, Bankwest and HSBC vacating their premises at 175 Pitt Street due to Dexus' planned redevelopment, in addition to the relocation of Australia Post from 175 Castlereagh Street.

Additionally, large clothing retailers such as Marcs, David Lawrence and Kit & Ace, have ceased operations and this resulted in vacancies along Pitt Street, Park Street and Martin Place which have traditionally been tightly held. With the new Tiffany & Co flagship store set to open at 175 Pitt Street (2,275m^2) in 2018 this is expected to tighten vacancy as the current tenants (Longines and Proview Optical) relocate to new tenancies.

Arcades and laneways have experienced fluctuations in vacancy over the past 12 months peaking at 3.7% in Q3 2016 to now stabilising at 2.6%. This was brought about by a rise in vacancies in the Dymocks building and QVB with the likes of Alannah Hill and the ABC Shop ceasing operations in the second half of 2016. On the back of these vacancies Cosmetic Laser Clinic, Buttons and Envoy all leased space in the Dymocks building, reflecting the short letting up period and thus retightening the vacancy levels. Additionally, high-end shoe retailer Brando has opened its first stand alone store in the QVB, enhancing the presence of the higher end retailers across the market.

The increasing number of international retailers in the market such as H&M, Zara, Uniqlo and COS has increased competition and put pressure on retailers to adapt and evolve in the competitive environment otherwise they will not succeed. Canadian retailer Kit & Ace which leased space at 5 Martin Place in early 2016, has recently ceased its operations at its flagship store to focus on E-Commerce operations. Despite the loss of the retailer this now presents a significant opportunity for a new tenant to occupy space in Martin Place. Furthermore, General Pants Co located on Pitt Street at MidCity Centre will be vacating its premises of over 400m^2 in the near term, thus allowing a new entrant to penetrate one of the most tightly held and sought after retail strips within Australia.

Tenancy Mix & New Supply

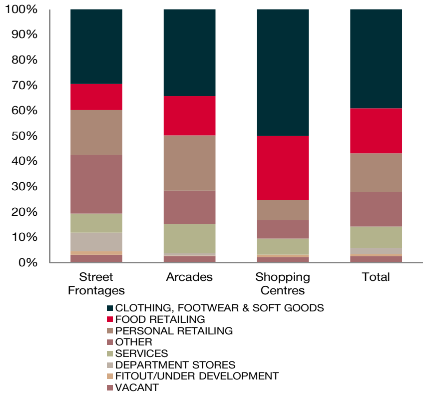
As at July 2017 clothing, footwear & soft goods represented 39.1% of the retail tenancy mix in the CBD, remaining constant over the previous 12 months. Shopping centres accounted for the majority share of clothing, footwear and software goods with 50.1%, slightly down from the previous corresponding period.

Nike is set to open its first flagship NikeTown store at 319-321 George Street in the near term. Although outside the Knight Frank Prime retail CBD definition Nike will join the likes of global clothing retailers Burberry and Louis Vuitton further along George Street and enhance George Street as a retail destination on the back of the Sydney Light Rail project.

Food retailers have the second largest presence within the Sydney CBD retail Core at 17.8%, underpinned by shopping centres where the representation jumps to 25.3%. Notably, the proportion of food retailers increased its presence by 0.6% over the past year within shopping centres. Although outside of the Knight Frank Prime CBD definition, DEXUS' recent Gateway retail redevelopment opened with renowned food retailers such as the Burger Project, Adriano Zumbo and Four Frogs Crêperie, reflecting the competitive nature and number of "well known" food retailers having a stronger presence in the CBD. Additionally, food retailers can act as a drawcard to attract tenants into a building as they create a vibe and ambiance around the building.

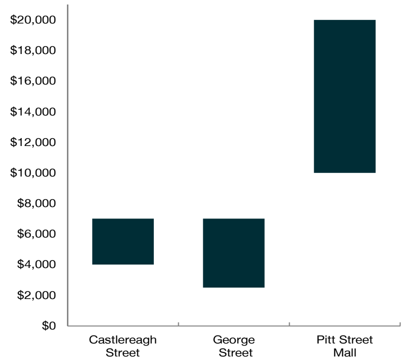
Late 2016 saw the completion of Charter Hall's 333 George Street office led development. This is the first of a wave of new mixed use developments along George Street, following the construction of the light rail. NAB and HSBC established flagship branches at 333 George Street, while Woolworths leased the lower ground floor for their Metro concept store.

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

Additionally, a number of other banks have leased space at prime retail sites including CBA at 200 George Street, Bankwest at 254 George Street and Westpac at 99 Pitt Street. This trend highlights the banks re-positioning in the market place to have a stronger physical presence, a trend which is being well received by owners as it provides a strong and secure tenant profile for the retail space. Elsewhere, the redevelopment of Chifley Plaza recently reached completion and houses a mix of fashion and high end food retailers.

Future supply of retail space in the coming 12 months will stem from the $75 million redevelopment of ISPT George Place (345 George Street) which will see 3,000m^2 of prime retail space added to the market, the space has experienced strong interest with a proportion already pre-committed. Furthermore, the Fife capital development at York & George (383 George Street) will add a further 5,000m^2 to the market. The developments highlight the expansion of the prime retail core to encompass George Street in addition to the traditional Pitt Street Mall sites.

Tenant Demand & Rents

Despite the softening vacancy and stronger presence of international retailers, luxury retailers and banks, gross rental rates have remained steady in the 12 months to July 2017. Pitt Street Mall still remains the standout super prime retail core with gross rents ranging between $10,000/m^2 and $20,000/m^2. With General Pants Co vacating its premises in the near term, this will provide a clearer indication of the current state of rents along the super prime Pitt Street strip.

There has been no change to the lower and upper end ranges along Pitt Street (outside Pitt Street Mall) over the past 12 months, despite a number of new lease deals including Mick Simmons, Sketchers and Chemist Warehouse occupying space.

Retail space outside Pitt Street (George Street and Castlereagh Street precincts), remain unchanged averaging between $5,000/m² and $7,000/m² (see Figure 2). More recently, amidst the light rail construction and numerous retail redevelopments along George Street, Nike, Superdry & Michael Hill will be opening stores along George Street. This reflects both the influx of international retailers into Sydney and the increased demand for space along George Street.

Investment Activity

Off the back of strong investment sales in the FY16 ($873 million) including the partial sale of World Square and MidCity Centre, investment activity was lower this year. This is not due to a lack of demand but rather the lack of available options as owners/investors have chosen to hold their assets.

The only significant sale in the past 12 months is the David Jones store on market Street. The site was purchased for $360 million by Scentre Group in conjunction with Cbus Property. David Jones will vacate the premises in 2019 which will allow for a full mixed use redevelopment of the site which is rumoured to include around 10,000m^2 of new prime retail space.

Whilst not a full retail sale 106 King Street, comprising ground floor retail and three upper floors currently used as office space sold for $20 million in June 2017, purchased by Iris Capital.

The Soul Pattison heritage building at 160 Pitt Street with 450m^2 of super prime retail space came to market mid last year with expectations it would reach more than $100 million, however the site has since been withdrawn from the market and has more recently come available for lease.

TABLE 2
Recent Sales Activity Sydney CBD Retail

Address	Price ($m)	Initial Yield	GLAR (m^2)	$/m^2 GLAR	Sale Date
106 King Street	$20.0	N/A	280	71,428	June-17
37 York Street	$3.57	4.3%	92	38,804	May-17
66 Hunter Street (Rockpool)	$30.0	6.3%	2,000	15,000	Aug-16
Market Street (David Jones)	$360.00	4.5%	32,030	11,239	Aug-16

TABLE 3
Recent Leasing Activity Sydney CBD Retail

Address	Tenant	GLAR m²	Rental Rate ($/m^2 p.a)	Term yr	Lease Date
MidCity Pitt Street Mall	Swarovski	100	N/A	N/A	Jun-17
139 Pitt Street	Joe & the Juice	240	2,083	10	Sep-16
112 Castlereagh Street	Van Cleef & Arpels	400**	5,000*	10	Sep-16
383 George Street	Optus	400#	N/A	10	Jun-17
QVB	Brando	49	5,306	5	Mar-17

Source: Knight Frank Research *Approx.
** Van Cleef & Arpels has occupied space over GF (200m²) and B (200m²)
# Optus has secured space over GF (200m²) and L1 (200m²)

Outlook

- Despite the rise in vacancy levels and a number of retailers ceasing operations in the past 12 months (Pumpkin Patch, David Lawrence, Kit & Ace and Marcs) this presents a unique opportunity for new tenants to enter the market in the coming 12 months, with large prime sites at 5 Martin Place and Pitt Street Mall/ MidCity Centre becoming available to lease.

- Competition in the market is anticipated to remain robust among the large international retailers (Uniqlo, H&M and Zara) and luxury brand retailers. Retailers will need to continue to adapt and evolve with consumers changing spending habits in order to remain successful. The future of Topshop at 45 Market Street is still yet to be determined as it currently sits in voluntary administration, pending this process it will determine whether they vacate the large premises which has an entrance to the QVB.

- Looking ahead, the new developments at 345 George Street and 383 George Street will add approximately 8,000m^2 of new prime retail space to the market. In conjunction with the new CBD light rail, there is set to be an expansion to the CBD prime retail core.

- Established retailers like Nike, Superdry and Michael Hill Jewellers opening stores in the near term along George Street reflects the positive implications of the Light Rail and the rejuvenation of George Street. This indicates that the retail strip will become highly sought after by a broader range of retail tenants in the future.

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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