Knight Frank

RESEARCH

MAY 2013

SYDNEY CBD STRATA OFFICE

Market Brief

World Square (Midtown precinct)

HIGHLIGHTS

- The 2012 calendar year (CY) saw a recovery in sales volumes across the Sydney CBD Strata office market after the lows experienced in 2011. The total volume of sales increased by 45% over this period with $136.5 million transacting despite only a modest rise of 3.1% in the total number of sales. Capital values also showed a limited increase of 1.7% to a current total market average of $5,122/m^2.
- The Core continues to be the most expensive precinct at $5,832/m^2 followed by the Western Corridor and the Midtown averaging $4,999/m^2 and $4,979/m^2 respectively. The Southern precinct averaged more in total volume than it had in each of the previous 11 years driven by increased overseas investment.
- With limited supply of new and refurbished suites, investors are seeking quality in location and finish to attract the best returns. Enquiries by owner occupiers and SMSF's have also increased driving further investment into the beginning of 2013.

Table 1
Sydney CBD Strata Office Market Indicators 2012 CY data

Precinct	Number of Transactions No.	Number of Transactions (%p.a)	Total Volume of Sales by Value $mill	Total Area of Sales (m^2)	Average Capital Value# ($/m^2)	Average Capital Value# (%p.a)	Average Sale Price# $	Average Sale Price# (%p.a)
Core	49	-10.9	37.5	6,431	5,832	15.6	765,356	30.4
Western Corridor	32	-3.0	39.1	7,828	4,999	5.5	1,222,800	46.9
Midtown	60	-3.2	39.3	7,897	4,979	-3.5	655,358	56.6
Southern	20	122	14.9	3,816	3,903	-18.1	744,650	29.0
Waterfront	5	150	5.6	674	8,348	-11.1	1,125,363	-24.6
Total	**166**	**3.1**	**136.5**	**26,646**	**5,122**	**1.7**	**822,129**	**40.5**

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

SALES ACTIVITY & CAPITAL VALUES

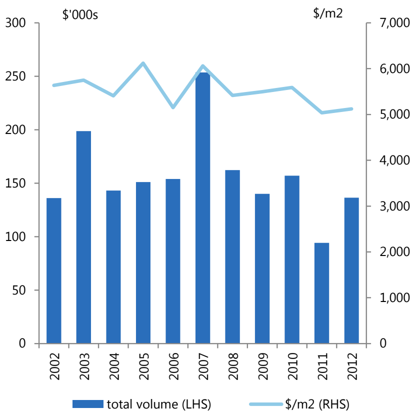
Sales Activity

Sales activity across the Sydney CBD Strata office market in the 2012 calendar year (CY) showed a recovery from the ten year lows experienced during 2011 with total volumes reaching $136.47 million. While investors are seeing value in newly developed strata space, there has been limited new supply added to the market during the 2012 CY. Growth in average capital values has dominated precincts with new additions reflecting this demand for high quality stock.

Over the 2012 CY, the average capital value achieved across the Sydney CBD market was $5,122/m^2 which is a slight increase of 1.7% over 2011 results. Over the past decade, strata has gone through two main growth phases. Firstly in the period after 2003 where investors looked for alternative investments to the residential market and again in late 2007 when a sharp drop in total CBD vacancy rates saw owner occupiers buy strata as a good shelter from growing office rents. The total volume of sales by value increased by 45% compared to 2011, despite only a 3.1% increase in the overall number of sales. Growth in volumes advocates stabilising economic figures and the perception of improved confidence in the market as interest rates hit historical lows.

The Core remains the most expensive precinct with average capital values

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

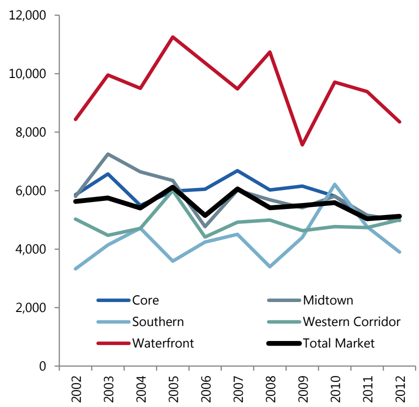


Source: Knight Frank Research

increasing by 15.6% on 2011 figures to $5,832/m^2. In spite of this, Midtown and the Western Corridor overtook the Core as the most invested precinct in 2012 with total volume by value reaching more than $39.3 million and $39.1 million respectively. Average capital values fell by 3.5% in Midtown and grew by 5.5% in the Western Corridor, aligning them just shy of $5,000/m^2 each.

The Southern precinct, with historically limited transactions saw its greatest total level of volume over the past 11 years with the number of sales more than doubling from 2011. This was underpinned by sales in The Manning Building at 451 Pitt Street and 368 Sussex Street in Chinatown, where demand is primarily driven by Asian investors both overseas and domestic. Despite this increased activity, the precinct saw a drop in average capital values of 18.1% over the 2012 CY as the higher number of transactions has given greater clarity to values in this precinct.

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



Source: Knight Frank Research

Sale Size

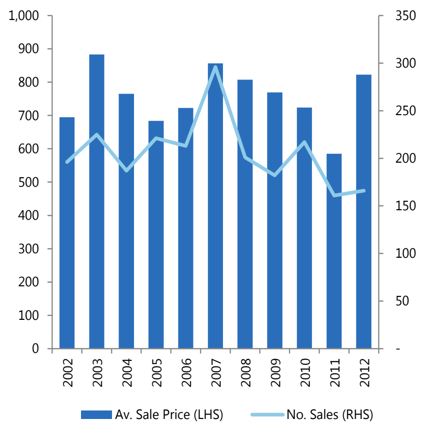
The average sale price during the 2012 CY across all precincts was $822,129, which is the highest level experienced since the 2007 growth period representing a 41% increase over 2011 results. This was primarily driven by the Midtown and Western Corridor precincts which grew by 57% and 47% respectively, with the Western Corridor rising to achieve its highest average sale price since 2002. This was due to multiple in one-line sales in buildings such as 65 York Street and 257 Clarence Street. This sales activity continued the trend away from the Core and further South due to the greater quantity of stock available. Another key indicator pushing up prices has been the increased activity by Self-Managed Super Funds (SMSF's) in the sub $1 million market throughout 2012 as they looked to take advantage of favourable tax benefits and the lull experienced in 2011.

This rise in the average sale price is also due to the reversal of the trend in 2011 which saw suites between 0 and 100m^2 account for 67% of all sales. The 2012 CY witnessed a move back to larger office suites (101m^2 plus) with the number sold representing 52% of total sales, the first time sales above 101m^2 outweighed those less than 100m^2 over the past 11 years.

Figure 3

Average Sale Price & No. Sales

($'000) Sydney CBD – Annually



Source: Knight Frank Research

Despite an increase of 46% in the total area of sales to 26,646m^2, the number of transactions only rose by 3.1% to 166 sales in 2012. This confirms the trend towards larger strata suites as average sizes rose by 38% reaching their highest level in a decade to 160.5m^2 as opposed to 116.2m^2 in 2011.

SUPPLY ACTIVITY & OUTLOOK

New Supply & Vacancy

Following the initial growth phase in 2003 where supply and values for CBD Strata office suites begun to take off, there has been a slowdown in the delivery of new quality stock to service the market. Over the last 11 years, this has affected the average capital values with new or refurbished stock demanding higher than average rates in each precinct. This is evident with last year's launch of the new core offering at 350 George Street where it is reported that 90% of the 64 suites sold off the plan. Suites ranging between 16m^2 to 69m^2 have reportedly sold at rates above $9,000/m^2, with prices advertised at over $10,000/m^2.

Across the broader CBD office market, overall vacancy rates have lowered significantly from the cyclical peak of 9.7% in January 2012 to 7.2% in January 2013. Due to the high incentive environment during 2012, some tenants relocated to greater quality space reducing the Prime vacancy rate. This highlights an opportunity for B and C grade stock to be strata subdivided or even older strata assets to be refurbished or sold for redevelopment to capitalise on this limited supply. With the standard set by successful projects like 350 George Street, this has led to rumours of plans for the strata subdivision of the Sydney Gas Works building at 36 Hickson Road, opposite the Barangaroo redevelopment site, by W Property. However, this project would only add less than 2,000m^2 to the overall strata market.

Outlook

In 2011, the Sydney CBD Strata office market experienced its most challenging results where volumes and activity were at their lowest over the last decade. However, the 2012 CY saw a recovery in the strata market as the total volume and number of sales increased whilst average capital values remained relatively steady despite improved investment and activity. This has been bolstered by improving economic figures of late 2012 leading to increased confidence among investors into 2013, but also shows the volatility that quality of stock has between different precincts.

Looking at the total Sydney CBD market, vacancy rates are expected to tighten further between now and the end of 2014, partially driven by increased stock withdrawals before expected new supply is released in 2015. Incentive levels are forecast to remain elevated before a steady decline from 2014. Investment markets are set to benefit in 2013 from a broadening base of buyers with continuing demand from offshore investors. Although the Significant Investor Visa (SIV) does not specifically allow investment into direct property, its introduction has no doubt been a factor in the increased enquiry levels from overseas investors in the strata market. The SIV will lead to a further influx of investment capital, particularly from Asia.

During the first quarter of 2013, enquiry levels among owner occupiers has also increased, triggered by executives establishing their own consultancies and the continued investment of SMSF's in the $500,000 to $1 million price bracket as they look to take advantage of the low cost of borrowing. However, competitive leasing options in the CBD along with potential tax changes applicable to SMSF's may dampen continued enquiry and investment at the 2012 CY rate.

New and refurbished properties will continue to command a premium in the Strata office market, with emphasis on the Core, Western and Midtown precincts. High quality assets will be the principal driver of any future capital value growth in this market for investors and owner occupiers alike.

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
Associate Director, NSW Research
+61 2 9036 6766
Nick.Hoskins@au.knightfrank.com

David Francis
Research Assistant
+61 2 9036 6628
David.Francis@au.knightfrank.com

Commercial Agency Contacts

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

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

Andy Hu
Executive, Asian Markets & Commercial Sales
+61 2 9036 6613
Andy.Hu@au.knightfrank.com

Richard Horne
Managing Director, NSW
+61 2 9036 6622
Richard.Horne@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 **KnightFrank.com.au**