



Q3 2018

Market Research Report

KARBON

PROPERTY



Market Snapshots.

Global Market

- US economy is reportedly operating above the full employment level therefore boosting consumer expenditure
- Last quarter, corporate profits in the US were boosted to 16.9%, as a result of corporate tax cuts > the strongest result seen in 6 years
- It is predicted that economic growth will remain strong for the rest of the financial year

Australian Market

The Australian economy grew at a rate of 3.4% > very strong result considering the impacts of the drought on the Agriculture sector.

- Strength in household spending was made clear with a 0.7% gain in the last quarter for household consumption
- Investment in new residential properties grew 3.6%, despite a slowing market
- Construction had a growth rate of 5.2%

Australia's population reached 25 million people in August, 30 years ahead of official forecasts made in 1998 by Australian Bureau of Statistics

- Population boosted by overseas migration
- In 2017, 240,400 people migrated to Australia, 85% of which settled in Sydney, Melbourne and Brisbane > Government now providing financial and employment incentives to immigrants to settle in regional areas to boost population outside of capital cities

Sydney Market

- There is \$4.8 billion worth of projects currently under construction in the CBD and \$3.1 billion worth of projects that have been approved (but haven't begun construction) due for completion in 2025.
- Both tourism and the appealing lifestyle of Sydney are boosting demand for prime residential apartments in the CBD, city fringe and eastern suburbs.
- Last year, Sydney's population grew by (just under) 102,000, of which 85,000 were from overseas migration.
- Sydney has a 2% growth rate which is high compared to the national growth rate of 1.6%

Australian Office Market

Out of the top 10 markets in Australia with the lowest office vacancy rates, NSW holds 5 positions. In the past financial year, total returns for the national office sector were at 14.7%, the strongest result in 10 years. This was clearly boosted by Sydney's office markets whereby office space in the CBD returned 17.6% with capital returns of 12.1%, as investor interest for CBD space remained strong.

Sydney CBD Office Market

Office vacancy in the Sydney CBD area is the lowest it has been in the last 10 years. The Urban Developer reported that vacancy has dropped to 4.6% from 4.8%, stating that the recent Barangaroo office precinct development (completed in 2017) has absorbed 30,046 sqm of tenant demand, as a result, the vacancy rate in the area almost halved. Amongst this decrease, the Property Council of Australia reported that there has been an increase in vacancies of A grade offices.

July 2018	Total Market	Premium	A Grade	B Grade
Vacancy	4.6%	5.1%	4.6%	5.1%

Source: Colliers Edge

Moving forward, office vacancy in Sydney's CBD is predicted to continue tightening until January 2020, as demand continues to strengthen and supply weakens. Knight Frank reported that the overall vacancy rate in the CBD will continue to drop to 3.0% by mid-2020, until the next supply cycle begins. Due to the tightness of the market and low vacancy rates, owners have been able to increase rents. In mid-September, Knight Frank reported that over the last 12 months, the CBD's prime gross effective rent has increased by 17.7% while secondary gross effective rent has increased by 16.9% and rents are expected to continue to increase until the next supply cycle.

On the other hand, there is currently a 'construction boom' in Sydney that is anticipated to boost the supply of office space in the CBD. The next supply cycle will begin in 2020 and as previously stated, there is \$3.1 billion worth of projects in the CBD that have been approved and are due for completion by 2025, including 16,260 sqm of office space above Pitt Street's future metro station. This is expected to result in vacancy rates rising, easing pressure on tenants and those looking for space in the CBD.

Sydney Fringe Office Market

The Sydney fringe office market is experiencing strong tenant demand. Suburbs such as Pyrmont and Surry Hills are becoming increasingly popular with technology firms, especially since the announcement that Google purchased Channel 7's Pyrmont HQ. It is reported that this purchase will be in addition to Google's new headquarters near Central railway station, involving 3 office towers connected to the station. Once the move occurs, it can be expected that technology firms will be attracted to the southern CBD precinct and immediate surrounding fringe suburbs such as Chippendale, Ultimo, and Surry Hills, leading to an increased demand in these areas and decreased interest in the outer fringe suburbs.

Research shows that small to medium-sized enterprises, education and technology are common occupiers of the city fringe who tend to favour shorter lease terms and lower rent, while still remaining in close proximity to the CBD. Cushman & Wakefield reported that fringe rent is approximately 30% less than rent in the CBD, with A grade net rent in Darlinghurst and Surry Hills currently averaging at \$675 per sqm while rent in Pyrmont is currently averaging at \$655 per sqm.

The Sydney city fringe market is the fastest growing market in the country, according to Savills, and continues to strengthen. It is expected to remain tight over the next 3 years. Karbon Property's Director and Founder, Joshua Watts, commented on what the tightening of the fringe means for the market:

"With the tightening of the fringe market, groups seeking 3,000sqm 'plus' are now sourcing the southern markets due to the fact that the critical mass of residential and retail is now in abundance. The message from developers sourcing pre-commitment is to offer a CBD "fringe" A grade style offering with floor plates above 2,500sqm to make it attractive over smaller floor plates in the inner city. The larger the floor plate typically means greater efficiency with less space required. In my opinion, we will see 2- 3 major commercial developments totaling approx. 60,000sqm commence in Q1 of 2019 which should see enough supply for tenants through to 2021."

In mid-September, architects revealed designs for a 45,000-seat stadium above Central Station. While the NSW Government's initial reaction to this was "lukewarm", the proposed stadium has the potential to be served by all of Sydney's rail lines, buses and light rail, making it more easily accessible than Allianz Stadium and ANZ Stadium. If this development was to be approved it would create a new surge of interest in surrounding suburbs, especially for creative firms involved with PR and the entertainment industry.

With the increasing popularity of the fringe office market, it is predicted that there will be upward pressure on rents within the area over the next 12 to 24 months.



195 Gloucester Street, The Rocks

Area	Tenant
170 sqm	CHAMP Ventures

Method

Karbon Property successfully completed an off market leasing campaign by reaching out to a number of boutique operators looking for a property with character. This was accomplished in a matter of weeks.



830 Elizabeth Street, Waterloo

Area	Tenant
170 sqm	Office Pace

Method

Karbon Property were able to match a tenant looking for a property that had a flexible base build opportunity within a unique but quality building.



529 Elizabeth Street, Surry Hills

Area	Tenant
Full Floor	Daniel Wellington

Method

Karbon Property successfully compiled a range of options suitable for the new Australia Head office for Daniel Wellington and were able to match both their requirements and tight time frame with 529 Elizabeth Street, Surry Hills.

Our Q3 2018 Commercial Leasing Highlights

The Karbon Point of View

"Karbon Property have recently launched the campaign for 2 strata offices at 301 Castlereagh Street, Sydney. Sizes of 49 sqm and 85 sqm are on offer. These suites are being sold fully refurbished with a personalised fitout, making the opportunity highly attractive to owner occupiers and investors looking to save on such costs. Being within close proximity to the Downing Centre, Town Hall, Haymarket and Surry Hills, the southern CBD presents as a popular location where the city meets the fringe.



Despite tighter lending restrictions from major banks, purchasing strata as opposed to leasing, can still present as a more affordable option if finance can be provided. The CBD strata leasing market is still extremely tight and while interest rates remain at historic lows, the market is indicating that enquiry for such a product will continue to remain strong. At this stage of the campaign, both suites are under contract with genuine interest around the \$12,000 per sqm mark.

In Fringe markets, A-grade quality strata product is still trading at high rates and on tight yields. A recent transaction at 50 Holt Street, Surry Hills achieved a rate over \$14,000 per sqm, and on a net passing yield of 5.75%. In South Sydney, smaller strata suites in Alexandria are achieving rates between \$8,600- \$9,000 per sqm with yields ranging between 5.5 – 6%. In Mascot, rates of \$8,500- \$9,000 per sqm are being achieved at the brand new development, 289 King Street, Mascot."

Tom Williams - Associate, Karbon Property

Commercial: Sydney Strata Sales

After peaking in July 2017, the Sydney residential market has slowed down. In the 2017/2018 financial year, it was found that;

- 44,818 houses were sold, an 11.8% decrease from the year before
- Detached house prices have declined by 6.2%
- 27,707 apartments were sold, a 20.4% decrease from the year before
- Total vacancy across the residential market was 2.7%

As reported by JLL, residential price growth in Sydney is now in negative growth and further declines are probable going forward, however no major collapse in prices is anticipated.

The housing boom was driven by Sydney's growing population, which hit 5 million people at the end of June, and ultimately strained supply and drove housing prices up. As a result, a vast amount of residential properties were developed to accommodate for the sudden surge of interest in Sydney which has now led to an oversupply of property. In the last year banks have tightened their credit policies and enforced stricter lending standards, making it harder to get a loan, resulting in less people being able to purchase property, ultimately driving housing prices down. The combination of these 2 factors has created what has been described as 'the housing market downturn'.

This is forcing landlords to lower their rents to stay competitive and secure tenants, otherwise they risk having vacant property generating no income. Vacancies have increased as a result of strong completions over the last year, but remain healthy. This is good for tenants as lower rents and more vacancies mean they have more options when looking for a property, and will likely be offered premiums or incentives upon signing a lease.

Sydney Residential Leasing

The Karbon Point of View

“Having suffered a slow winter period, we are now seeing an increase in activity as is usual at this time of year. The real change in this market is the savvy prospective tenant who now has choice where they haven’t had before, mainly due to the number of properties they now have access to on the Sydney residential market. Rent and presentation of the property are both playing a large factor in their decision making. Just because the property is ‘modernised’ doesn’t mean the owner will necessarily get a higher rent. It pays to get a full market comparison and make a good assessment of the local market before deciding on rent. A rental property that has been on the market for a few weeks is open to negotiation from prospective tenants that are keeping an eye out for potential bargains.”

Patricia Mahn - Associate, Karbon Property



Sydney Residential Leasing

The trade war commenced as the US imposed tariffs on Chinese goods as a form of punishment for China's trade practice of forcing foreign businesses to trade their best and most innovative technology in exchange for access to the Chinese market.

The Trump administration has now imposed tariffs of \$200USD billion worth of Chinese goods (\$279 billion AUD) meaning that it will become more difficult for US consumers to access Chinese goods, with them now facing a higher border tax making goods more expensive to import into the US. China retaliated by imposing tariffs on \$60 billion worth of US imports, specifically targeting US agricultural exports such as soybeans – impacting farmers in upper mid-west states including Illinois, Iowa and Minnesota. These are all states Trump needs to secure in order to win a second term as president, and so securing their financial stability should be of high importance to the current US government.

Although both countries will face economic consequences of this trade war, China will feel a greater impact as they export 4 times as much as they import, with an expected decrease in their imported goods.

While the trade war poses a risk to the global economic outlook, Australia has already begun to feel the impact. In an attempt to stabilise its economy, China is recalling its capital by asking Chinese companies and groups to turn their investments and purchases home to China, rather than in overseas markets.

Recently, the Chinese government asked Chinese-based property developer Hailiang Property Group to sell a \$600 million project in Erskineville. This follows news of property conglomerate Dalian Wanda's exit from the Australian real estate market, selling 2 high profile projects – 'Jewel' in the Gold Coast and 'One Circular Quay' in Sydney – to Yuhu Group for \$1.3 billion.

At this stage it is unclear how long this trade war will last. Economists argue whether it will be over by Christmas or if it will last for 20 years, however the general consensus is that the 2 nations will be forced to come to an agreement to avoid a serious decline in employment, with current tariffs threatening to negatively impact future trade flows and economic growth.

Retail: The China Trade War

The Karbon Point of View

Our Director of Retail provides some commentary on the positive side effect Australia may experience from the trade war:

“The trade war does not only affect the US and China- this a global matter that we as individuals can only observe through media avenues. The greatest effect this trade war will have on the Australian property market is the restriction on an individual or entity transferring funds out of China, and current conditions mean we are already feeling the slowdown of the overall market, which our local banks are not exactly assisting with.

I believe that importance should be placed on our response on the impact of the trade war and the approach we take, rather than knee-jerk reaction to the potential damage to both international and domestic property markets. I view the present slowdown as a great opportunity and the next big property class to attract attention and gain popularity are stratum retail/commercial properties for sale. With the current market noise of over-development within Sydney, there is a significant amount of retail and commercial properties within this classification that will soon see new ownership I believe mainly from local based investors with international property knowledge.



Andrew Ou - Director, Retail Services

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