HARTIGAN BOLT
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Office Leasing, Commercial Sales and Property Management
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Market Report

Prices Soar to New Highs and Rents Set to Rise

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Back in 2012 the Reserve Bank's base rate was 4.25% a level that, at the time looked quite low. Little did we know that in the next 4 years' interest rates across the world would fall to nominal levels and our rate would tumble to 1.5%.

The effect of cheaper money on property prices has been quite dramatic with owners seeing capital gains of 60% + and for some far more.

Despite the increase in prices, demand for commercial property remains extremely high and many owners are still reluctant to sell. As a result purchasers are having to compete aggressively when there is an opportunity to buy.

In the second half of 2016 we concluded a number of sales at records prices and yields as low as 3.8% confirming that prices had jumped higher again. Full details of these are included on pages 2 & 3.

We have already exchanged contracts on two properties this year in Lane Cove and are getting ready to market two commercial investments.

While capital values have soared in response to lower interest rates, it has taken longer for commercial rents to start moving but even here there is positive news. The high vacancy rates that existed 4 years ago have receded to much lower levels and has allowed landlords to start increasing face rents and reduce lease incentives.

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Demand for office space is running at healthy levels and being helped by the continued growth of the NSW economy. On the supply side construction of new commercial buildings is at very low levels and total stock is declining as commercial buildings have been acquired for residential development and for the Sydney Metro.

In the CBD demand has been sufficient to absorb the massive Barangaroo project and maintain the overall vacancy rate at a low 6%.

On the North Shore the vacancy rate is higher at 8% but there is only one commercial development under construction at North Sydney and supply is tight for refurbished B Grade space where many buildings are now fully leased. In North Sydney, B Grade office rents are now $650psm+. In the CBD a similar shortage has pushed some B Grade rents up to $1,000 psm.

With little new supply being added in the CBD or on the North Shore in the next 2 years there will be a continuing tightening in the market which will allow landlords to increase rents further..

Sale Prices Power On

We calculate that commercial values have increased by at least 60% in the last 4 years and for some owners' prices will have doubled. Most of this has been triggered by cheaper money with the RBA reducing the cash rate by 65% since 2012. Going forward rental growth is emerging and will help to sustain this momentum.

Sales in the second half of 2016 included a $10M+ investment in Chippendale which attracted more than 130 enquiries. Strong bidding at the auction pushed the price to $11.4M and a yield of 4.2%.

In Willoughby Road, Crows Nest a retail and office investment sold within 4 weeks of marketing at a price of $5.6M and a yield of 3.8%

Not to be left behind two commercial strata investments also proved extremely popular. A whole floor at 39 Hume Street, Crows Nest sold at a record price of over $1.9M and a floor at 73 Walker Street, North Sydney sold just before the year end for $1.75M.

This year we have already exchanged contracts on two sales in Lane Cove with a combined price of over $20M and expect to start marketing two commercial investments shortly.

Recent Sales

2 Apollo Place, Lane Cove West

4,095sqm leased to Optus
Contracts Exchanged

Recent Sales

110-112 Willoughby Road, Crows Nest

Prime retail investment

- Freehold retail & offices
- Building area 385sqm
- Kurtosh Bakery on lease to 2020
- Fully leased to 4 tenants
- Income approx. $216,000 p.a.

Sold $5.61M – Yield 3.8%

232-236 Cleveland Street, Chippendale

Leased to Dulux to 2020

- City fringe investment
- Building area 1,144sqm
- Site 1,151sqm
- Income $480,000 p.a..

Sold $11.4M – 4.2%

37 Egerton Street, Silverwater

Freehold Industrial

- Corner site of 2,325sqm
- Warehouse & offices
- Short term lease to Aussie Post
- Income $240,000 p.a.

Sold $4.0M

Reasons for Moving

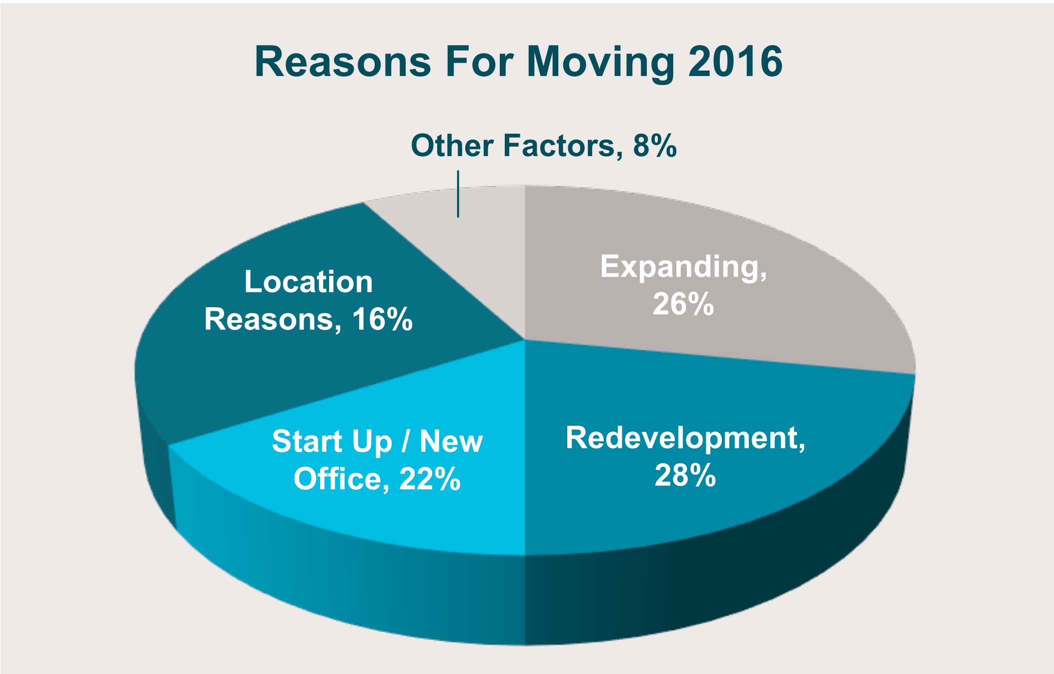
In 2016 our leasing teams in North Sydney and Chatswood secured tenants for over 20,500sqm of offices across the North Shore. Our activity was evenly spread between the markets of North Sydney, Crows Nest / St Leonards and Chatswood / Artarmon. We have also leased almost 3,000sqm in other areas including Lane Cove and Northbridge.

2016 was the fourth consecutive year in which we recorded an increase in leasing activity. This sustained period of demand has pushed vacancy rates down to a level where landlords have been able to increase rents and reduce the large incentives that have been a hallmark of the leasing market for some years.

With very little supply of either new or refurbished offices coming on the market in the next couple of years vacancy levels will continue to fall and rents will rise further.

As the chart below illustrates demand in 2016 was boosted by tenants that had to move due to redevelopment. This included tenants in buildings acquired for the Sydney Metro as well as in buildings that were acquired for residential development.

Expansion and businesses setting up an office were the other dominant factors driving demand.



Limited supply will add to pressure on rents

Like most of Sydney the North Shore has seen a boom in residential development in recent years. The same however cannot be said for the commercial market where new construction has been limited with little sign of this changing in the next couple of years.

The most recent office development in North Sydney was Suntec's, 177 Pacific Highway which is now fully leased.

The only scheme currently under construction is a 40,000sqm development at 90-100 Mount Street, North Sydney, which is scheduled for completion in 2018. Beyond this there are plans for a 40,000sqm office tower above the former Shopping World complex which should be completed in 2019 /2020. This represents a very small overall addition to the total supply of office space at a time when vacancy levels are tightening.

In addition to a low level of supply of new A Grade buildings there has been a real lack of buildings being refurbished to provide good quality B Grade offices. As a result B Grade rents have jumped to over $650psm gross in North Sydney and are likely to rise further in the next year.

This increase in rents would normally prompt more owners to upgrade older buildings however the number that are available for refurbishment may be limited.

In St Leonards and the fringe of North Sydney a significant number of commercial buildings have been redeveloped for residential and many more are in locations where residential schemes are planned. These owners will understandably not wish to expend capital on refurbishment.

Another factor hindering refurbishments is the high proportion of older buildings that are strata titled. This is an issue in North Sydney as well as Crows Nest and St Leonards. The NSW Government has changed strata legislation to try and promote renewal of strata buildings and we will comment later on the opportunities that this will present for strata owners to maximise value.

Given the time lag in bringing developments and even refurbishments to the market it is unlikely that there will be any meaningful increase in supply in the next 2 years. As a result vacancy levels will continue to fall and provide landlords with the opportunity to increase rents. After many years in which tenants have held the balance of power this will be a significant shock to many occupiers.

2016 was the first year for many that we have seen any significant increases in rents across the North Shore. Our view is that this trend has much further to go as the combination of healthy demand, lower vacancy levels and limited supply will cause rents to rise.

Strata changes help prices to catch up

There is a huge opportunity for strata owners to benefit from the recent changes to strata laws and look at collective sales. This has already lead to a significant jump in strata prices with more to come.

The State Government's changes to strata legislation has removed one of the great impediments to strata values namely the fact that it's been almost impossible to redevelop an ageing office strata.

Whatever one's views are on the fairness of the proposed changes, there is little doubt that the ability to push forward with a sale of an entire strata building without having every owner on board will make "whole of strata sales" easier and help to reduce the discount in pricing between strata and freehold.

Already this has pushed up the sale prices of individual strata office with recent sales showing rates in excess of $6,000 / sqm compared with around $4,500 - $5,000 / sqm just 12 months ago.

Our most recent strata sale at 73 Walker Street achieved a rate of over $6,100 / sqm. We also achieved over $8,000 / sqm for a floor in Hume Street, Crows Nest. This was influenced by being opposite the site of a future Metro Station. Nevertheless, it is a strong indicator that strata prices are catching up with freehold rates and becoming far more sought after.

The proposed changes allow for a collective sale to occur providing there is support from 75% of lot owners. This will help to overcome the many situations where one or two reluctant owners prevent others from maximising their properties value by getting together for a combined sale.

Across the North Shore there are many older office strata that are ripe for redevelopment and could yield more value from being redeveloped or sold to a single owner for major refurbishment.

Recent Strata Sales

L1, 73 Walker Street, North Sydney

Strata Investment

- Whole floor of 285sqm
- 2 Car spaces
- Lease to 2020
- Income approx. $119,000 p.a.

Sold $1.75M - $6,140/sqm

L2, 39 Hume Street, Crows Nest

Opposite Future Metro Station

- Top floor of 235sqm
- 2 car spaces
- Leases to 2017
- Income approx. $81,000 p.a.

Sold over $1.9M

Highlights....

- The effect of cheaper money on property prices has been quite dramatic with owners seeing capital gains of 60%+ and for some far more.
- Demand for office space is running at healthy levels and is being helped by the continued growth of the NSW economy.
- In the CBD demand has been sufficient to absorb the massive Barangaroo project and maintain the overall vacancy rate at a low 6%.
- The North Shore vacancy rate is around 8%.
- With a limited supply of new developments and refurbishments in the next couple of years vacancy levels will fall further and rents will rise.
- There is only one new commercial development currently under construction at North Sydney and one further scheme due to commence later this year.
- Demand for B Grade space has also been strong and has resulted in more B Grade buildings being 100% leased.
- B Grade rents are now $650psm + in North Sydney and in the City some have reached $1,000psm.
- In 2016 we leased over 20,500sqm of offices across the North Shore. This was the fourth year in which we recorded an increase in leasing activity.
- The strata market is poised for real change with recent changes to legislation making it much easier to organise a redevelopment or refurbishment without being blocked by a minority of owners.
- Already strata prices have jumped with recent sales in excess of $6,000psm. Even at this level they have some way to go to equal freehold prices.
- Strata owners have a huge opportunity now to organise collective sales and remove the discount that has traditionally applied to strata offices.

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