SYDNEY CBD'S PLANNING CHANGES AND THE IMPACT ON OFFICE VALUES

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Commercial office space is seen as the heartbeat of Sydney CBD and pivotal to its status as Australia's most productive and strategically important employment center, generating over $108 billion of economic activity annually.

However, development of new residential floor space has recently outweighed commercial development growing concerns for the city's future workplace and business capacity. In response, the City of Sydney has released its Central Sydney Planning Strategy to help plan for growth and facilitate an engaging City Centre that serves its forecast employment growth.

The Central Sydney Planning Strategy (first released in 2016) identities and translates the city's spatial controls to set a planning landscape that will balance the long-term residential land market whilst encouraging growth of commercial, retail and cultural space within Sydney CBD. The City of Sydney Council has now exhibited the planning strategy (as an unofficial exhibition) in attempt to force the Department of Planning to expedite approval.

With 580,000sqm of office stock withdrawn from the market since 2015 and commercial office rents and capital values having increased by approximately 40-50% in recent years one can't help but question what impact the new planning will have on values.

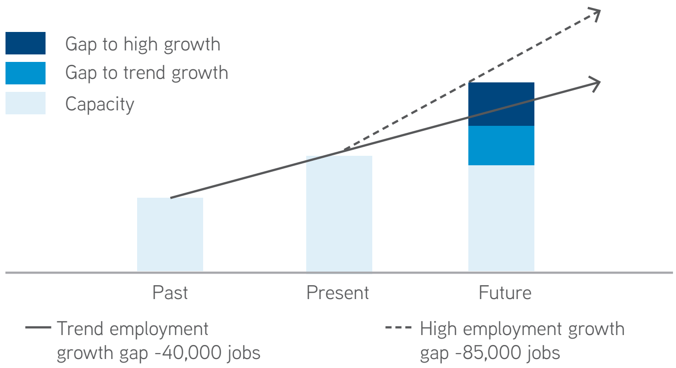
Why are the planning changes required?

Unprecedented withdrawal of office stock for hotel and residential development, and the governments compulsory acquisition of 19 CBD buildings has not been offset by new office development. Central Sydney's Planning Strategy has been designed with the aim of preserving Sydney's continued dynamism for business and economic growth.

New planning strategies will encourage increased commercial development to protect the city's economic vitality and resilience, providing development incentives to respond to the changing needs of the market.

Central Sydney's employment growth trends require 90,000 new jobs and an additional 1,800,000sqm of office floor space by 2036. In 2012 Central Sydney had approximately 745,000sqm of total available floor capacity under existing controls and 1,000,000 including government approved sites (such as Barangaroo and Wynyard Place). However, recent development trends statistics note that 52% of new floor space has been residential. Assuming the remainder 48% is commercial this means by 2036 there will be a gap of 40,000, meaning an 800,000sqm shortage of new office space (20sqm/person) whilst anticipation of high employment growth would require 1,700,000sqm of new stock.

Forecast Sydney CBD job growth



What are the major changes

Major changes to planning include:

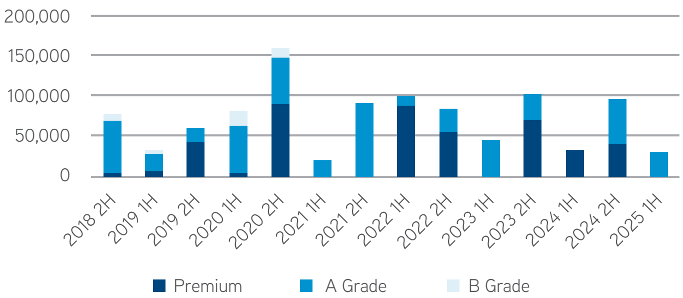
1. Floor Space Ratios (FSR's) being increased for office and reduced for residential
2. Limiting residential development to 50% of space on buildings over 55 metres
3. Increasing density and heights
4. New planning will require a site area of 1,000sqm to achieve bonus FSR in addition to Base FSR. (Current planning does not require a minimum site area to achieve bonus FSR)

There are three areas identified as potential tower cluster zones that may permit for potential development up to 300 metres, based on site specific assessment. This provides opportunity for site specific approvals and scope for additional floor space to exceed current development controls based on site specific merit.

How will these changes impact supply and the office investment market?

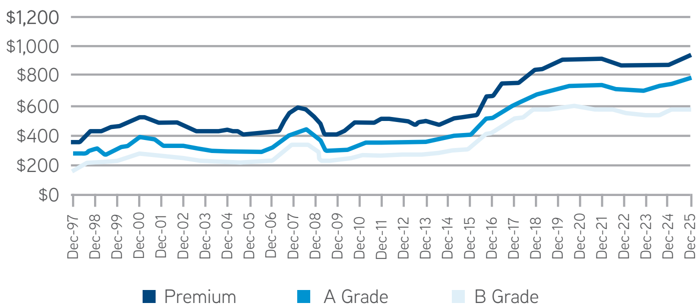
There is currently already a new supply pipeline underway that is meeting trending employment growth until 2024, delivering approximately 100,000sqm of new office per annum. Upon gazettal, the new planning strategy is expected to increase CBD office FSRs, encouraging greater commercial development and quicker planning approval times for commercial use.

The current supply pipeline - by grade



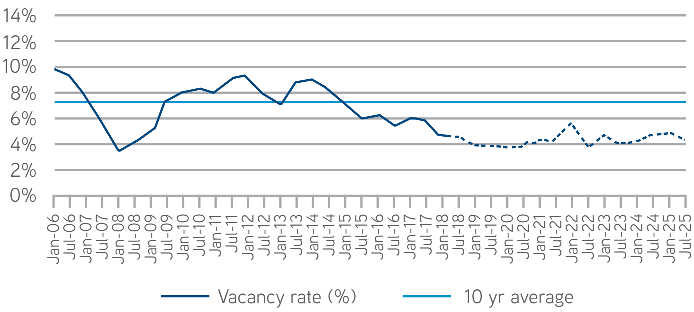
The pipeline of stock currently being delivered is already influencing the leasing market with net effective rents stabilising, as seen below.

Sydney CBD average net effective rents



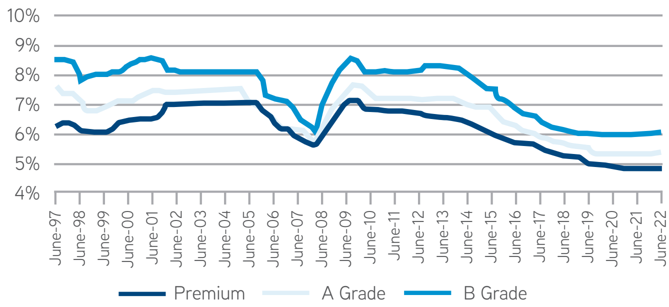
Vacancy has declined to historical lows and new development is expected to stablise vacancy over the medium to long term.

Sydney CBD office vacancy rate



Yields are at their lowest levels in history. This has seen the buyer type shift from investors chasing returns to those looking to place capital as a safe haven for investment. Dominant buyers are emerging from Hong Kong, Singapore & Macau. For example, the refurbished heritage building of 230 Clarence Street, Sydney has just sold for $50,000,000 to a Hong Kong investor for $19,612/sqm on a 3.6% initial yield. The RBA has only recently announced its record low cash rate of 1% (July 2019) which we expect will deliver some further yield compression. However, we expect this will balance the reduction in net effective rents and likely see capital values remain stable over the shorter term. Upon gazettal of the strategy we expect to see an increase in office development that will effect leasing market dynamics and capital values in the longer term.

Sydney CBD average yields



What does this mean for owners and investors

Developers are having to regard the new planning changes, land banking, particularly within the tower cluster site areas with the aim of increasing their site footprints to achieve additional height uplift upon planning gazettal. For example, major players including Investa, Lendlease and Built are acquiring adjoining buildings or blocking stakes of at least 25% + to stamp their control over adjoining strata properties. Strata legislation laws introduced in late 2016 have made this possible which requires 75% of lots to agree before a building can be sold.

With the minimum site area to develop above 55 metres set to increase from 800sqm to 1,000sqm under the Central Sydney Planning Strategy, smaller buildings when amalgamated with adjoining properties that combined will exceed 1,000sqm are providing an uplift in redevelopment value to owners.

Many owners are unaware of the planning changes and how they impact upon their property's value, and the development value of their property to adjoining owners for future development. We are already witnessing these planning changes filter through the market and are well positioned to assist owners position their assets in a way that capitalises on current market trends and the Central Sydney Planning Strategy.

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