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HD **Sydney conversions vital**

BY Larry Schlesinger

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Office-to-residential conversions will safeguard the Sydney CBD office market from a vacancy blow-out in the medium term, commercial agents DTZ in a new report say.

About 700,000 square metres of new office stock will be added to the CBD market between now and 2018.

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But at the same time 275,000 square metres of lower grade Sydney office space is expected to be permanently withdrawn for conversion to apartments. Taking into account other changes to the office mix, the net position will be 303,000 square metres of new office space added to the market over this time frame and putting a floor under any correction in face rents.

"Without these office withdrawals the vacancy rate would peak at 11.3 per cent rather than at 9.85 per cent in 2016-17 under our baseline scenario," Dominic Brown, head of research at DTZ, said.

Dr Brown said the consensus view was Sydney's CBD was in the early stages of a slow and steady recovery in tenant demand, but that this recovery was "robust".

Permanent office withdrawals are likely to include 19,500 square metres at 201 Elizabeth Street tower, where Asian developers are jostling for the $350 million offering.

Another is Goldfields House at 1 Alfred Street with 24,000 square metres of office space, which Shanghai-based developer AXF Group is circling, and 231 Elizabeth Street, with 23,000 square metres of office space sold by Investa to Singapore's Bright Ruby for $201 million in March last year.

Permanent office withdrawals and increased demand for space from a wider range of tenants beyond IT and telecommunications will ensure net face rents remain broadly unchanged as the market absorbs more new stock.

As the supply cycle draws to an end in 2017-18, stronger tenant demand is forecast to result in more pronounced net face rental growth of up to 4 per cent a year under DTZ's baseline scenario and between 2 per cent and 5 per cent across all scenarios.

DTZ's baseline, most likely - scenario encompasses an "unspectacular, recovery" in the national economy. A worse case scenario, rated as having an only a 10 per cent change of occurring would be a mortgage-lending induced financial crisis in China.

Nearly half of new A-grade office supply will come from the completion of the three commercial towers at Barangaroo South, which offer a combined 300,000 square metres of office space.

The first tower is due for completion next year.

Even under a worse-case scenario, net absorption would be positive, Dr Brown said. He said incentive levels had likely peaked in Sydney at about 30 per cent and would come down between now and 2018, meaning "slightly higher effective rental growth".

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