

PETER HUTCHINS' SPEAKER NOTES.

**Property Council of Australia (NSW) - Commercial Office Forum.
Beyond the CBD - The Future of Sydney's Suburban Office Markets.
(Sydney - 10 August 2011)**

Speakers.

- Charles Moore Fund Manager, Commonwealth Property Fund - Colonial First State Global Asset Management;
- David Rees Head of Research - Jones Lang LaSalle;
- Frank Sartor Former Lord Mayor of Sydney and former NSW Government Minister;
- Peter Hutchins Managing Director - Charter Keck Cramer;
- Peter Messenger Senior Managing Director - CB Richard Ellis, Global Corporate Services.

Moderator.

- Whitney Fitzsimons ABC *Business Today* presenter.
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Context Setting.

In a room full of Sydney experts, I am a casual observer.

Economic headwinds have had a compounding effect on the Sydney office market due to its "Wall Street" profile. Despite the recent office market research showing Sydney to be the only CBD market to record an increase in vacancy over the six months to July 2011, shifting from 8.3% to 9.3% - the highest vacancy rate for five years - the medium term outlook for Sydney is bright.

Key themes influencing corporate behaviour:

- Economic conditions;
- Business confidence;
- Cost;
- Workplace innovation;
- Location;
- Infrastructure.

Today's discussion should unmask some of the issues confronting your market which, understood and addressed, can lead to opportunity.

Workspace Ratios as a Driver of Office Demand.

- Since the onset of the GFC in 2008, there is a new world order, and now more than ever companies need to constantly re-invent themselves. Companies are either:
 - 1) Pace-setters;
 - 2) On the curve;
 - 3) Left behind.

We know that talent thrives in active and collaborative workspaces, and pace-setting companies that realise this are investing heavily in human capital and working environments that support the investment. Telstra, NAB, Macquarie and GPT are all pushing the boundaries of workplace innovation.

With the world economies again on their knees (fried up beyond all recognition), speed to market becomes critical for the survival of organisations in a capital-constrained and highly competitive environment.

- Technology is driving change and supporting greater workplace flexibility and mobility. Tracking accountability for a mobile workforce is an issue, as is lower professional and social interaction. We have 10 "home offices" in our business, and as small as that sounds, the prevailing theme from our annual performance review process was the need for greater professional and social interaction;
- I recently had the opportunity to tour Telstra's Experience Centre in Melbourne, a window into the future. Technology supporting the way we work, rest and play on the one hand is very exciting, although in some ways a little overwhelming, particularly the de-personalised nature of human interface;
- Hot-desking of the 1990s is now being replaced with activity-based workplaces (ABWs).
Hot-desking = companies with employees spending a considerable amount of time out of the office.
ABWs = mobility and flexibility, encouraging individuals to move around with the freedom to choose types of work setting that suit their task, whether individual tasking or collaborating in teams;
- The industry is in a process of evolution rather than revolution.

Capacity in the Sydney CBD.

- It has always been very hard to aggregate sites due to land cost and a disparate ownership profile. In addition, market forces always determine highest and best use, which has seen the conversion of many office buildings into residential apartment developments. It would be a brave Government that intervened to regulate market forces favouring offices over residential;
- Whilst I am not an expert on Sydney, it seems that you have Barangaroo, City Central, the suburban markets of North Sydney, Parramatta, Chatswood and North Ryde. It strikes me, however, that cheap and abundant land exists in "South Sydney", already supported with rail infrastructure and could play an important role in the long term future of Sydney's office market;
- Melbourne is an interesting case study. Fifteen years ago the CBD was dead. Residential development breathed life into the CBD, where it now has active laneways and streetscapes and vibrant 24/7 activity. The Melbourne CBD's pressure valve was, of course, Docklands, which has been a success story, allowing commercial office campus development on the fringe of the CBD;
- 2006: Apartments represented 3% of all private dwellings nationally:
 - 61% of that number was in Sydney and 17% was in Melbourne;
 - From 2006 to 2007, apartment numbers have doubled in Melbourne, which has not been the case in Sydney.

Barangaroo.

- 22 hectare industrial site, heavily contaminated;
- Development expected to be completed by 2020 at an estimated cost of \$6 billion;
- Three main precincts: Headland Park; Barangaroo Central; and Barangaroo South;
- *Headland Park* and *Barangaroo Central* will be more of the public open space area;
- *Barangaroo South* will be the focus of most development. Included in the approved Masterplan will be offices, apartments, hotels, restaurants and a museum;
- Current approval exists for 490,000 square metres of commercial office accommodation - this was recently boosted from 430,000 sq.m.. Sydney City Council is trying to cap the space at 300,000 sq.m. as there is a concern that the current approval is too big.

Sydney Fast Facts.

Economic Tension has Sydney Pausing for Breath.

- The short term view is that Sydney's high exposure to the global economy makes it sensitive to headwinds in financial markets;
- The vacancy rate has risen from 8.3% to 9.3%, the highest in five years;
- Supply additions over the same period totalled 111,552 sq.m., 44% more than the 20 year average;
- "A" grade vacancy up from 9.4% to 9.9%, with 42,838 sq.m. of demand offset by a decade-high addition of 84,611 sq.m. of supply.

Why Move to the Suburbs?

Why Go To North Ryde?

- In 2006, we were running a relocation project for the Australian Red Cross Blood Service, and North Ryde was clearly an option for investigation. At the time there was representation that the rail project would be delivered, supporting North Ryde as a legitimate office market. Five years later there is still no rail;
- Interestingly, steel wheels on steel gauge (rail travel) has one seventh the friction of rubber on bitumen. If rail is more environmentally sustainable, economic and efficient, why then are we spending so much money on roads? We know from examples in Europe that fast train travel is efficient for commuters and profitable for business enterprise;
- If transport connectivity is the Achilles heel to North Ryde, why do organisations commit? Productivity = reduced costs and higher volumes, and the Sydney suburbs are a cheaper alternative to the Sydney CBD, which is **not** the case in Melbourne;
- Difference in prime gross office rents between CBD and city fringe markets:
 - Sydney: 35% - 45%;
 - Melbourne: 5% - 15%;
- North Ryde is also a gateway to white collar employment and appeals to fully self-contained corporate within a campus environment, or back office functions.

North Ryde Profile.

- Including Macquarie Park (in North Ryde), Norwest Business Park (in Bella Vista / Castle Hill) is considered one of Sydney's major business parks and one of the largest nodes of suburban employment. Norwest is in the outer North-Western region of Sydney and about 27 km from the CB. It is also 11 km from the Parramatta CBD and 5 km from the Rouse Hill Town Centre;
- The 377 hectares business park commenced development in the 1990s in what was then a greenfield location. The original masterplan was completed in the late 1980s with full completion anticipated by around 2020. The masterplanned development consists of a mix of uses including **150 hectares for residential development** (Bella Vista Waters estate, Beaumont Rise estate, The Lakes medium density precinct in Town Centre), **180 hectares for industrial, commercial, retail and office development** and over 46 hectares for open space and waterways. The estate also benefits from direct access to the M2 and M7 arterial motorways;
- Major components of the project include:
 - Town Centre precinct:
 - ♦ Marketown Shopping Centre currently 9,700 sq.m. anchored by Coles with Liquorland and 35 specialty stores with approval to increase to @ 15,000 sq.m.);
 - ♦ Leisure precinct (restaurants, etc);
 - ♦ Ice-skating rink;
 - ♦ Swim school;
 - ♦ Childcare centre;
 - Bulky goods precincts including Totally Home Homemaker Centre (17,8 00 sq.m.) and Bunnings (8,200 sq.m.);
 - Crowne Plaza Hotel (132 rooms);
 - Circa Precinct:
 - ♦ Circa Retail (5,200 sq.m.) anchored by Woolworths with 25 specialty stores;
 - ♦ Provision for over 150,000 sq.m. of commercial and office development, serviced apartments, gymnasium, urban park, etc.; and
 - Norwest Private Hospital (@ 14,000 sq.m. including 170 beds, 10 operating theatres) and Q Central (associated @ 7,500 sq.m. of office suites primarily for medical consulting.



- The business park currently accommodates over 400 companies and is estimated to have the capacity to employ 30,000 – 35,000 workers and accommodate around 10,000 residents upon full development;
- Major corporates located in the industrial and office components of the development include:
 - ♦ Woolworths National Support Centre (2,600 staff consolidated from 9 previous sites in three connected campus style buildings of three and four storeys totalling 36,000 sq.m. of office space connected via a 2,500 sq.m. central marketplace);
 - ♦ ResMed;
 - ♦ AAMI Insurance;
 - ♦ Reserve Bank of Australia;
 - ♦ Subaru;
 - ♦ IBM Global Services;
 - ♦ Sigma Pharmaceuticals;
 - ♦ Australia Post;
 - ♦ Cathay Pacific Airways;
 - ♦ CSR;
 - ♦ Optus;
 - ♦ Schneider Electric.

- Thus far it is estimated that around 400,000 sq.m. of office floorspace has been developed across the various precincts of Norwest Business Park. The project has been successful at attracting those firms seeking a fully integrated working environment at cheaper rents than the CBD and other established suburban office markets. Unlike Macquarie Park, where the focus has been on distinct industry groups (e.g. IT and Telecommunications and Pharmaceuticals), Norwest has attracted a broader range of tenants, with most being manufacturing or retail/wholesale companies and few traditional CBD occupiers (finance / insurance and business services) relocating. Through the 2000s office floorspace absorption average 10,000 – 15,000 sq.m. per annum;
- Interestingly, the first redevelopment of an older building within the Business Park has just been announced (July 2011). The original use of the site, developed in the early 1990s, was as a brick, tile and building materials selection centre (to service the needs of the then nearby urban growth area through north-western Sydney) which was comprised of a single storey showroom and outdoor display areas. The current proposal relates to a new 7 level office building containing 11,00 sq.m. that is 85% pre-committed, 106 serviced apartments and specialty showrooms.

North Ryde Fast Facts.

Demand Keeps Ticking Up for North Ryde Office Market.

- Vacancy rate fell from 9.9% to 9.8%;
- Net absorption for "A" grade stock has driven down the vacancy rate from 9.3% to 8.4%;
- Negative demand in "B" grade space elevated its vacancy from 9.2% to 10.2%;
- 221,961 sq.m. mooted.

North Sydney/Parramatta Profile.

- Can't accommodate campus-style development due to land constraints and land cost. This situation is similar to Parramatta;
- It is difficult for a suburban office market to compete with higher and better uses such as residential, e.g. residential value per square metre \$10,000, commercial value per square metre \$5,000 - \$6,000.

North Sydney Fast Facts.

Strong Tenant Demand Returns to North Shore.

- Across the North Shore, net absorption was 24,206 sq.m. over the six months to July 2011, a rate five times the 20 year average.

Locale	Vacancy July 2011 (%)	Mooted (sq.m.)
North Shore	9.2%	96,898
Crows Nest/St Leonards	12.5%	32,552
Chatswood	17.0%	24,155

Parramatta Fast Facts.

Tenant Demand Continues In Parramatta.

- The vacancy rate in Parramatta decreased from 9.6% to 9.3%;
- No new space is due to enter the market in 2011, but 25,050 sq.m. are scheduled for 2012;
- 14,517 sq.m. of projects are planned to be completed from 2013 onwards;
- 71,878 sq.m. of space is mooted.

Why Invest in the Suburbs?

- Rental growth in the suburbs will be moderate at best due to the **low barriers** of entry leading to greater competition. Higher yields are simply a function of lower anticipated rental growth;
 - Given the current and forecast future state of capital markets, **institutional capital will always prefer a CBD location over a suburban location**. Campus design becomes critical in order to future-proof the asset, supporting a shift from corporate occupier to smaller businesses at initial lease expiry. The state of the market gives rise to what is an appropriate size office campus in the suburban environment, and the tipping point is probably 30,000 sq.m., or circa \$180 million;
 - The outlook for the office sector in general is favourable, and Sydney is seen as the most attractive geographic region. Demand for office space in the city was badly affected by the GFC due to its close association with the financial services industry. Sydney is being viewed as more attractive than other capital city markets due to the limited supply of office space coming on stream and the geographical limits on the city's CBD. Capital is looking for stability and low volatility, in contrast to what is happening in the global capital markets.
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How Do We Get People to Their Workplaces?

- The greatest cities in the world are supported by appropriate infrastructure. In many ways Australia is lagging in this respect, and particularly Sydney has been suffering under this burden for some time.
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Australian Office Market Fast Facts.

Market	Vacancy Rates - July 2011 (%)	Prime Rental Rates - CBD (p.s.m.)	Prime Rental Rates - Suburbs (p.s.m.)
Melbourne CBD	5.8%	\$500	\$450
Adelaide Core	7.3%		
Brisbane CBD	7.4%		
Perth CBD	7.8%		
Sydney CBD	9.3%	\$725	\$550
Canberra	13.3%		
Total - all CBD markets	8.4%		

- 700 Bourke Street, Melbourne - 63,000 sq.m. - National Australia Bank;
- 171 Collins Street, Melbourne - BHP Global Headquarters;
- 111 Eagle Street, Brisbane;
- 1 Shelley Street, Sydney - Macquarie Bank;
- 1 Bligh Street, Sydney.