Western Gateway Sub Precinct Proposal: Block B 14-30 Lee St, Haymarket NSW 2000

The Emergence of Australia's Leading Innovation and Technology Precinct

Research Report | September 2019

Contents

1. Executive summary.

1.1

Accommodating for transitioning tenant demand

THE TECHNOLOGY SECTOR WILL BE THE KEY DRIVER OF GROWTH

Australia is transitioning toward a knowledge-based economy, with Sydney – and the CBD in particular - being at the forefront of this evolution. Over the next decade, Colliers International anticipates the information technology and Technical Services sector to be a key driver of employment growth and office demand in the Sydney CBD. The NSW Government and the City of Sydney Council have recognised this vision and are embarking on an ambitious program to establish an Innovation and Technology Precinct in the Central to Eveleigh area. There is a significant amount of investment in new infrastructure and public transport networks currently underway.

Sydney is also home to Australia's largest financial eco-system with almost two-thirds of Australia's 100 largest companies (ASX 100) and many Fortune 500 companies currently headquartered there. The city is now home to 60% of Australia's Fintech (Financial Technology) companies and 48% of all start-ups. Colliers International forecasts that by the next decade, the Sydney CBD is expected to have more workers in the Professional, Scientific and Technical Services sector than the Finance and Insurance industry. This is further supported by the projection that the number of Science, Technology, Engineering, and Mathematics students in Australia are expected to exceed Management and Commerce graduates by 2021.

... BUT SYDNEY RISKS LOSING IT TO MELBOURNE

While there has been a strong emphasis on boosting employment, inadequate attention has been given to the supply side of the market. Modelling by Colliers International shows that the Sydney CBD is a naturally supply-constrained market as new development has generally lagged demand growth since the 1980s. The availability of new developments has had a significant bearing on employment levels over the past 20 years. Our analysis shows that new supply of office space has a strong causation effect on jobs growth. The lack of availability due to stock withdrawals and a low level of development over the past few years has put significant constraints on net absorption in the CBD.

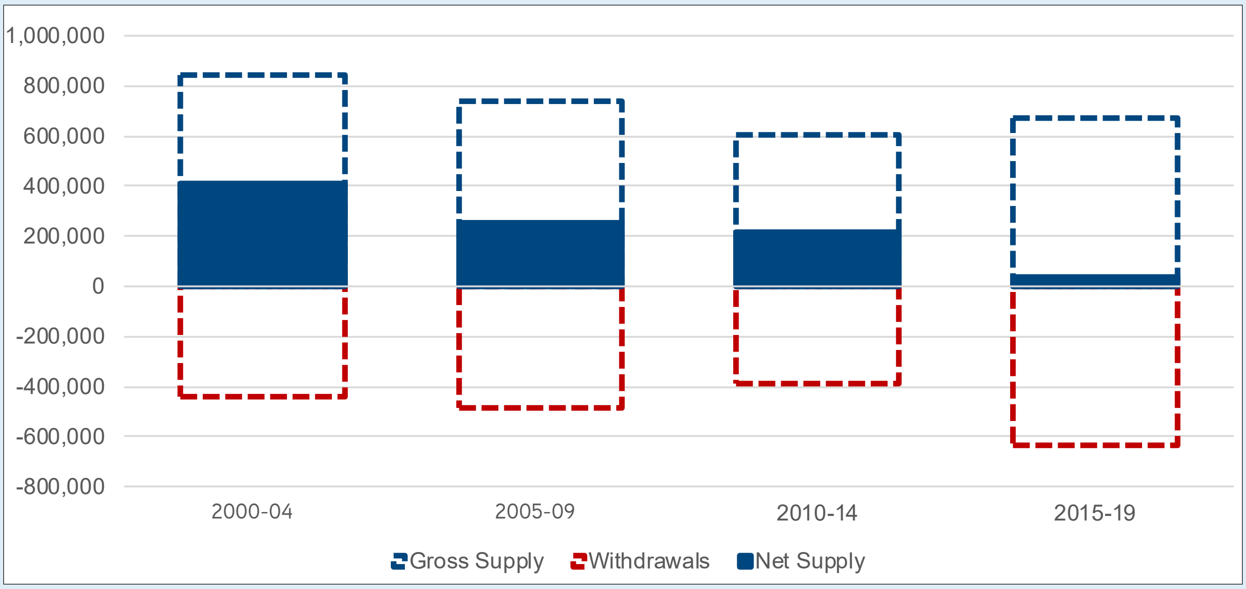
Total floor space in the Sydney CBD has declined from 5,098,358 sqm to 4,985,833 sqm over the past two years while Melbourne has increased from 4,524,598 sqm to 4,614,349 sqm. At the current rate of development Melbourne could overtake Sydney CBD as the largest office market in Australia over the next decade. The lack of new supply has already had negative impacts on employment growth in Sydney. Over the year to June 2019, white-collar employment in the Melbourne CBD increased by 4.7%, which is almost double the corresponding rate of growth in the Sydney CBD at 2.8%.

TABLE 1: Sydney vs Melbourne CBD Office Supply (Past 2 Years)

	Sydney CBD				Melbourne CBD			
6 Months to	Stock	Supply	Withdrawals	Net Supply	Stock	Supply	Withdrawals	Net Supply
Jul-17	5,098,358	83,534	-63,779	19,755	4,524,598	5,606	-7,183	-1,577
Jan-18	5,036,039	37,376	-99,695	-62,319	4,515,776	22,142	-30,964	-8,822
Jul-18	5,036,168	45,251	-45,122	129	4,541,855	59,613	-33,534	26,079
Jan-19	5,009,233	28,212	-55,147	-26,935	4,598,479	98,758	-42,134	56,624
Jul-19	4,985,833	8,639	-32,039	-23,400	4,614,349	64,054	-48,184	15,870

Source: Colliers International, Property Council of Australia

GRAPH 1: Sydney CBD Gross vs Net Office Supply Past 20 Years



Source: Colliers International, Property Council of Australia

> *Over the next ten years, forecasts by Colliers International indicate that the Sydney CBD would need to deliver up to 1.5 million sqm (gross) of new office space to accommodate the latent demand driven by the growth of future white-collar employment.*

SUPPLY IS INADEQUATE FOR FUTURE DEMAND

Over the past decade, for every 100 sqm of new stock being delivered in the Sydney CBD about 80 sqm of existing office space has been withdrawn for redevelopment or conversion to alternative uses. As a result, the total office floor space in the Sydney CBD has declined from 5,098,358 sqm as at July 2017 to 4,985,833 sqm as at July 2019. Meanwhile, the Melbourne CBD saw its stock increased from 4,524,598 sqm to 4,614,349 sqm. In fact, at the current rate of development and if the supply constraints of Sydney are not adequately addressed, the Melbourne CBD could potentially overtake Sydney CBD as the largest office market in Australia in the foreseeable future. Research by Colliers International also shows that the Melbourne CBD has already exceeded the Sydney CBD in terms of prime office floor space. There was 3,091,343 sqm of prime offices in the Melbourne CBD as at July 2019, compared to 2,985,360 sqm of prime space in the Sydney CBD.

Over the next ten years, forecasts by Colliers International indicate that the Sydney CBD would need to deliver up to 1.5 million sqm (gross) of new office space to accommodate the latent demand driven by the growth of future white-collar employment. About half of this growth is expected to derive from high tech jobs in the knowledge-based industries. The current supply pipeline, especially in the Southern Precinct of the Sydney CBD would be inadequate to meet the projected future demand. The precinct is characterised by an acute lack of significant development sites and fragmented ownership, hence preventing large scale development projects. Our insights into occupier demand in the tech industry around the world reveal that these occupiers are increasingly seeking flexibility and functional efficiency. This requirement is enabled by larger floorplates of 2,000 sqm or more. Tech companies around the world are the driving forces behind the rise of the urban tech campuses in downtown areas due to the flexibility and functionality that these campuses afford, as well as accessibility to a skilled workforce, amenities and public transport.

THE SOUTHERN PRECINCT OF THE SYDNEY CBD HOLDS THE KEY TO THE SUPPLY CONUNDRUM

The Southern precinct of the Sydney CBD surrounding Central Station is in a unique position to become Australia's and the Asia Pacific's most innovative commercial hub. It is well serviced by future infrastructure and amenities that meet the requirements of the occupiers of the future. With convenient access to Australia's leading universities, a large pool of STEM graduates, an abundance of entertainment options, affordable living options and a vibrant culture of innovation and creativity, the precinct is undoubtedly one of the most preferred locations for start-ups and technology companies. However, the current lack of large-floorplate office developments offering workspace flexibility and urban campuses remains the critically missing factor preventing the precinct to realise its full potential. The area is currently characterised by a proliferation of residential, mixed-use, small land parcels and fragmented ownership. The Southern CBD office precinct is 70% underutilised compared to the rest of the Sydney CBD in terms of floorspace per land area and generates 55% less employment per sqm of land compared to other areas in the Sydney CBD.

BLOCK B IS THE CATALYST FOR THE DEVELOPMENT OF THE SYDNEY INNOVATION AND TECHNOLOGY PRECINCT

Colliers International's analysis shows that there is a strong causation relationship between new supply and net absorption in the Sydney CBD. As a result, the delivery of new office space will have a positive effect on demand and unlock employment growth, especially in the tech-sector that has been constrained by space availability in recent years. As such, Colliers International believes that the Block B development will have a positive impact on the Sydney economy and will play a significant role in the revitalisation of Sydney's busiest transport interchange. The project will also provide an opportunity to deliver an expansive creative workspace that fosters the Sydney Innovation and Technology precinct and supports the city's enduring global competitiveness. A development of this significance will allow Sydney to attract and maintain its dominance as the most preferred location for corporate headquarters of local and international high-tech companies. In this report, we address the key trends and drivers of innovation hubs around the world and the requirements of innovative occupiers now and into the future.

> *“Colliers International believes that the Block B development would have a positive impact on the Sydney economy and would play a significant role in the revitalisation of Sydney's busiest transport interchange.”*

2. Introduction.

2.1

Introduction

Dexus CPA Pty Ltd (Dexus) and Frasers Property Australia (Frasers Property) (the Consortium) is seeking to build "a vibrant new business district and revitalise the face of Sydney's busiest transport interchange" (Project Vision) at 14-30 Lee Street, Haymarket, otherwise known as the Site or Block B within the Western Gateway Sub-Precinct, as illustrated in Figure 1.

The Western Gateway Sub-Precinct is made up of three landholdings as illustrated in Figure 2:

Block A – land predominately occupied by the YHA Hostel;
Block B – the Dexus / Frasers Property site subject of this report;
Block C – land on which the Adina Hotel and Henry Deane Plaza are located.

FIGURE 1: Central Precinct (White), Western Gateway Precinct (Orange shading), Block B (Red Outline)

FIGURE 2: Western Gateway landholdings

To facilitate redevelopment of the Western Gateway Sub-Precinct, the existing planning controls are required to be amended. This report supports a submission to the Secretary of the Department of Planning, Industry and Environment ('the DPIE') which seeks to amend the height and density controls within the Sydney Local Environmental Plan 2012 (Sydney LEP 2012).

The request to amend the planning controls follows the Minister for Planning and Public Spaces recent declaration identifying the Central Station Precinct as a State Significant Precinct (SSP). The Western Gateway, located within the Central Precinct SSP, is earmarked as a sub-precinct within the proposed SSP boundary for early consideration for rezoning.

Transport for New South Wales (TFNSW) is developing a vision for the growth and development of this precinct and is preparing a Strategic Framework to guide future detailed planning of the Central Precinct. The Strategic Framework will be placed on exhibition for public comment concurrently with the rezoning of the Western Gateway.

2.2

Project objectives.

The proposed rezoning forms part of a broader planning process being pursued by the Consortium to realise a shared vision and set of objectives for the Western Gateway and the Central Precinct more broadly. The overall Project objectives for Block B is to:

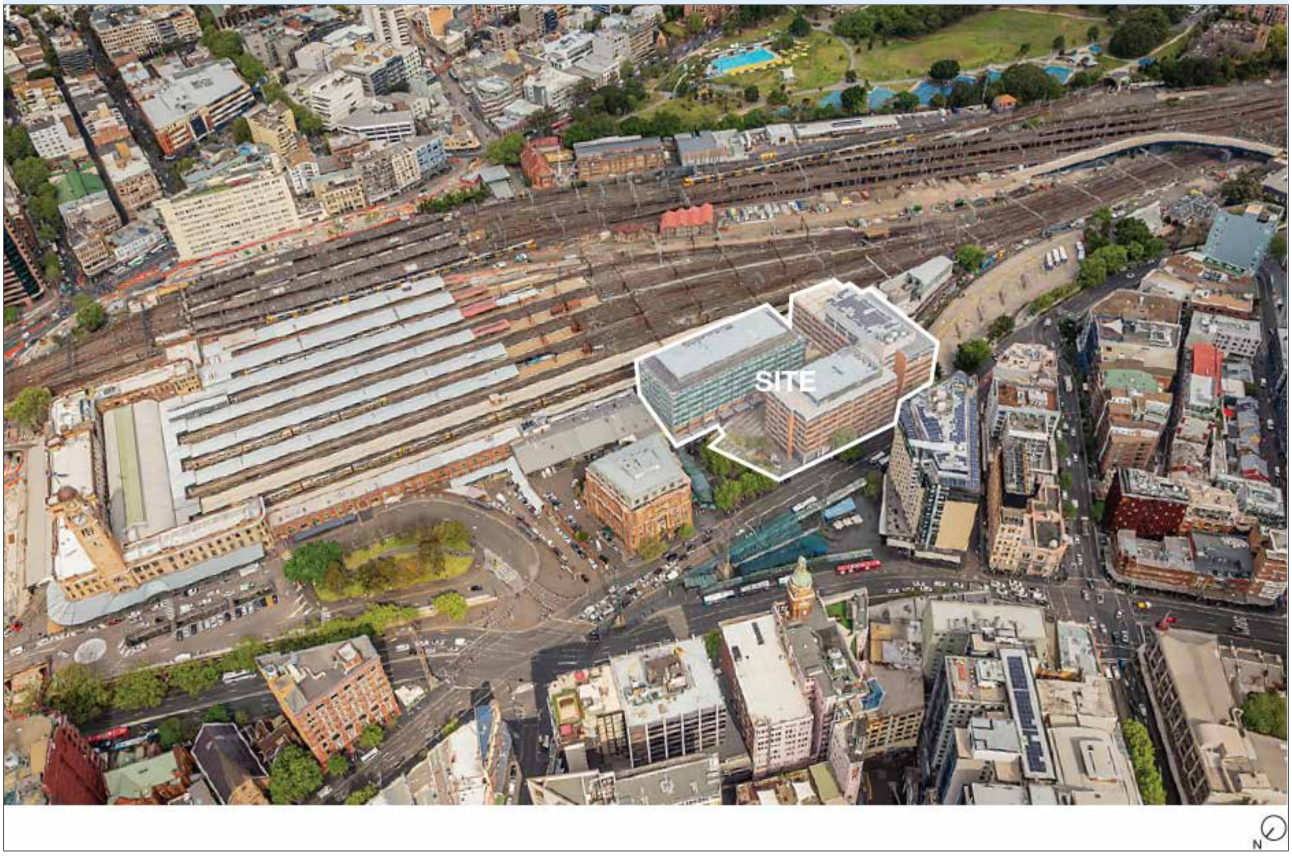
High tech jobs – Deliver creative workspace that builds the Sydney Innovation and Technology Precinct and underpins Sydney's enduring global competitiveness.

Transport connectivity – Redefine the experience of over 20 million pedestrians who walk through Henry Deane Plaza every year with world class public realm and connectivity.

A revitalised precinct – Transform Central into an exciting place with lively retail and dining options, supporting Sydney's day and night time economy.

Infrastructure for the future – Enable wider renewal of Central by delivering underground smart building services, waste and utility infrastructure necessary for an integrated and sustainable precinct.

FIGURE 3: Block B within the Western Gateway Sub-Precinct (existing)



2.3

The project.

The Consortium intends to develop up to 155,000sqm of commercial and retail GFA within a podium, two towers, lower and upper ground plane over a three level basement. The Project comprises:

Two commercial towers comprising 45,000sqm and 40,000sqm located above the podium with floorplates of approx. 2,050sqm and 2,350sqm GFA;

55,000sqm of commercial office space located within the podium which provide flexibility and campus style / large floorplates approx. 6,200m2 GFA,

A retail offering of approx. 5,000sqm accessible from lower and upper ground levels, including food and beverage catering to station, visitors and Western Gateway commercial occupants providing an activated frontage and interface to Henry Deane Plaza. This includes an activated Lee Street frontage and lobby located at upper ground level, providing access to the commercial office podium levels and towers above.

Three levels of basement car parking to accommodate:

- 48 service vehicle and loading dock parking and distribution area within an Integrated Distribution Facility (IDF)
- Service vehicle, loading dock and distribution area for all stakeholders within the Western Gateway;
- Provision for emergency, maintenance and service vehicle parking and distribution area for future Central Over Station Development (OSD within the IDF);
- 121 parking spaces for Block B occupants;
- Provision for Block A and C vehicle access via the Block B;
- Bicycle parking and end of trip facilities for staff;
- Bicycle parking spaces for customers/visitors;

Podium and tower rooftops designed for passive activation and gatherings for occupants of the Project to utilise and appreciate the views of the city and harbour;

Redeveloped public space and stairs from Block B to future Central Precinct Over Station Development (OSD) providing an east-west pedestrian connection to and from the Western Gateway Sub-Precinct;

Integration with a redeveloped Henry Deane Plaza to accommodate the increased pedestrian movement from existing and future pedestrian connections to various modes of transport;

To prepare Block B for future development, an increase in building height and floor space controls is sought. These proposed amendments to the Sydney LEP 2012 align with State, regional and local strategic planning objectives and initiatives.

This report should be read in conjunction with the Planning Statement prepared by MG Planning, and the other appended technical reports.

2.4

Site ownership.

The Consortium's Proposal relates to land located at 14-30 Lee Street, Haymarket. It is legally described as Lots 12, 14 and 15 in DP 1062447. Legal descriptions of each parcel within Block B are detailed below.

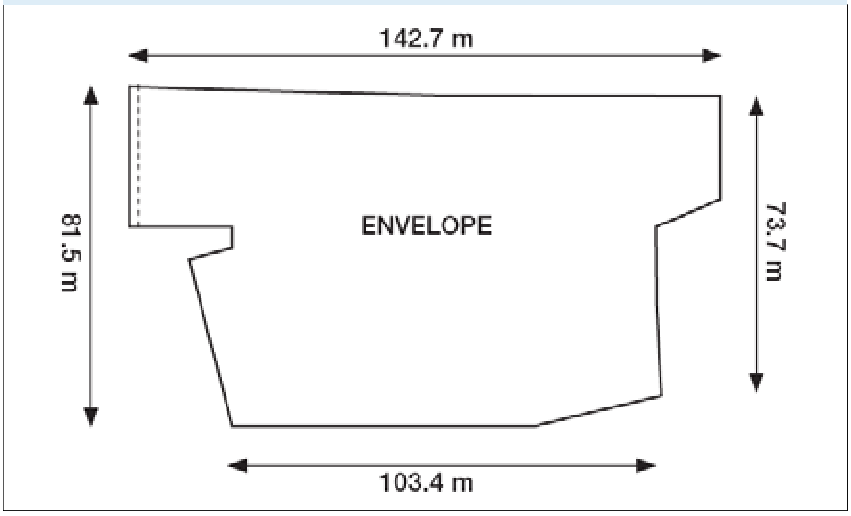
Title details	**Legal description**
Lot 12 in DP 1062447	The proprietor of the fee simple is Rail Corporation of New South Wales. The proprietor of the leasehold estate of the land and the buildings on the land created by lease AA651830 expiring on 30 June 2099 is Dexus CPA Pty Ltd A.C.N. 160 685 156.
Lot 14 in DP 1062247	The proprietor of the fee simple is Rail Corporation of New South Wales. The proprietor of the leasehold estate of the land and the buildings on the land created by lease AA651832 expiring on 30 November 2100 is Henry Deane Building Nominees Pty Ltd A.C.N. 081 941 951
Lot 15 in DP 1062447	The proprietor of the fee simple is Rail Corporation of New South Wales. The proprietor of the leasehold estate of the land and the buildings on the land created by lease AA651833 expiring on 31 March 2101 is Gateway Building Nominees Pty Ltd A.C.N. 081 951 822.

2.5

Site location.

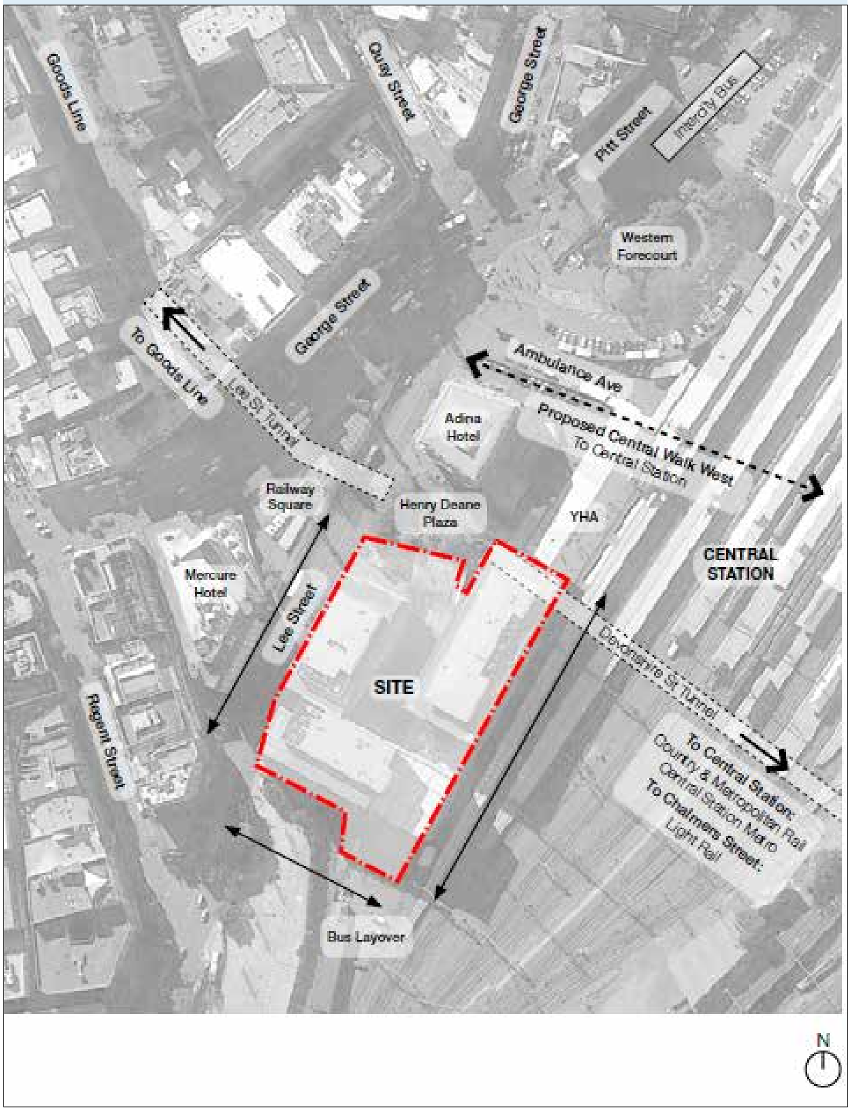
Located close to Central Station, Block B comprises land fronting Lee Street, Haymarket and is bounded by Henry Deane Plaza to the north, the railway corridor to the east, the Sydney Buses layover to the south and Lee Street and Railway Square to the west. Together it constitutes an area of approximately 9,632sqm at ground level, with a dimension from north to south of approximately 103-143 metres and approximately 74-81 metres from east to west (Figure 4).

FIGURE 4: Block B site boundary Source: Woods Bagot & SOM architects



Henry Deane Plaza (located on the lower datum) is centrally located within the Western Gateway and primarily funnels pedestrians between Devonshire Street tunnel, accessed from the Site's eastern boundary, and Lee Street tunnel, Railway Square, and tertiary institutions to the west.

FIGURE 5: Block B site boundary Source: Woods Bagot & SOM architects



The upper level of Block B flanks Henry Deane Plaza to the north and south (part of Block C). The State heritage listed Adina Hotel (part of Block C) and Sydney Railway Square Youth Hostel (YHA) (Block A) are located north of Henry Deane Plaza. South of Henry Deane Plaza is dominated by more contemporary office buildings of approximately 20 years of age which are occupied by State and Commonwealth agencies including Transport for NSW, Department of Immigration and Border Protection, Department of Foreign Affairs and Trade and Corrective Services NSW.

A range of food and beverage outlets and service retail tenancies are located across both the lower and upper levels across the Western Gateway precinct.

2.6

Sydney CBD office market analysis.

The office market analysis report titled “The Emergence of Australia’s Leading Innovation and Technology Precinct” prepared by Colliers International provides a detailed analysis of the Sydney CBD office market with a particular focus on the current conditions, constraints and opportunities of the Southern precinct of the Sydney CBD. For the purposes of this report, the Southern precinct office market is defined accordingly to the Property Council of Australia.

3. Macro outlook.

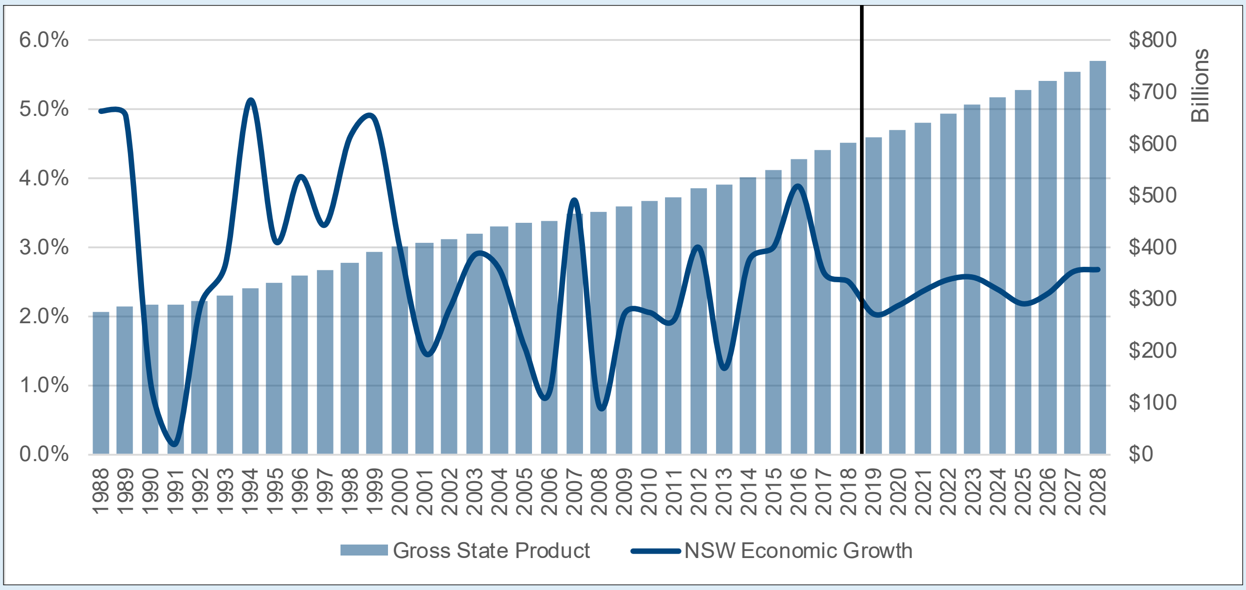
3.1

New South Wales remains Australia's best-performing economy

New South Wales continues to be the economic powerhouse of Australia and the most significant contributor to national GDP. The Harbour State is benefiting from the historically low-interest-rate environment, a massive infrastructure investment program and rapid population and employment growth coupled with an ongoing tourism boom. NSW Gross State Product (GSP) expanded by 2.6% during 2017-18 and growth is forecast to accelerate to 2.75% in 2018-19 (NSW Government), which is above the long-term trend. The stable economic forecast for NSW is underpinned by rising business and public expenditure in conjunction with increased consumption aided by low interest rates and the falling Australian dollar. Economic growth in the state is projected to persist at between 2.5% and 3.0%, which should provide strong fundamental support for demand in the property sector.

Rapid population increases further strengthen the healthy economic conditions of NSW. As at December 2018, more than 8.0 million people were living in NSW, representing nearly 32% of the Australian population. The population of NSW is projected to grow by 1 million over the next ten years, registering 100,000 new residents a year. Despite the strong population growth, NSW job growth continues to outstrip labour supply. This has led to a continued decline in unemployment and record levels of job vacancies. As at May 2019, nearly 81,000 jobs remained unfilled in NSW, with the majority of these jobs in the white-collar sectors.

GRAPH 2: NSW Economic Growth

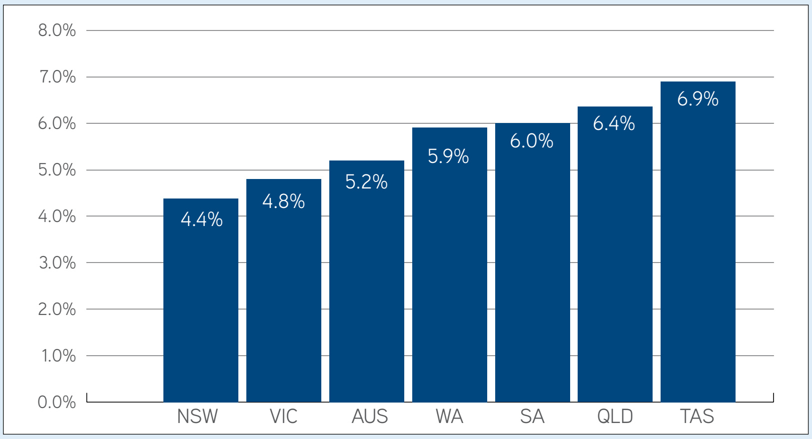


Source: Colliers International, Access Economic Forecasts

3.2

The lowest unemployment rate in the country

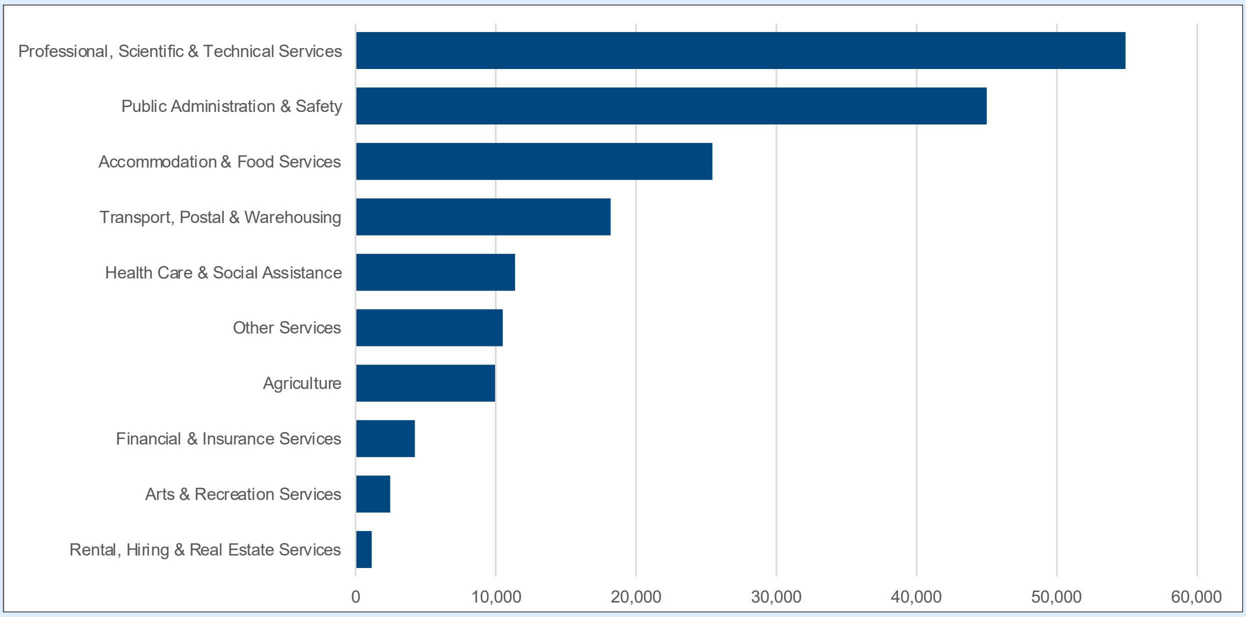
GRAPH 3: Unemployment Rates



Source: Colliers International, ABS

As at July 2019, the NSW unemployment rate stood at 4.4% (seasonally adjusted), which is 0.8% below the national unemployment rate of 5.2%. This is the lowest level of unemployment amongst all states and territories in Australia. The state unemployment rate has continued to trend down over the past four years from the cyclical peak of 6.3% in January 2015. The participation rate, on the other hand, has reached all-time highs of around 66% while employment growth continues to escalate. The catalysts for employment growth in NSW have stemmed from the knowledge-based and white-collar industries such as Information Technology, Technical Services and Finance and Insurance.

GRAPH 4: Job Growth by Industries (12 Months to March 2019)



Source: Colliers International, Deloitte Access Economics

3.3

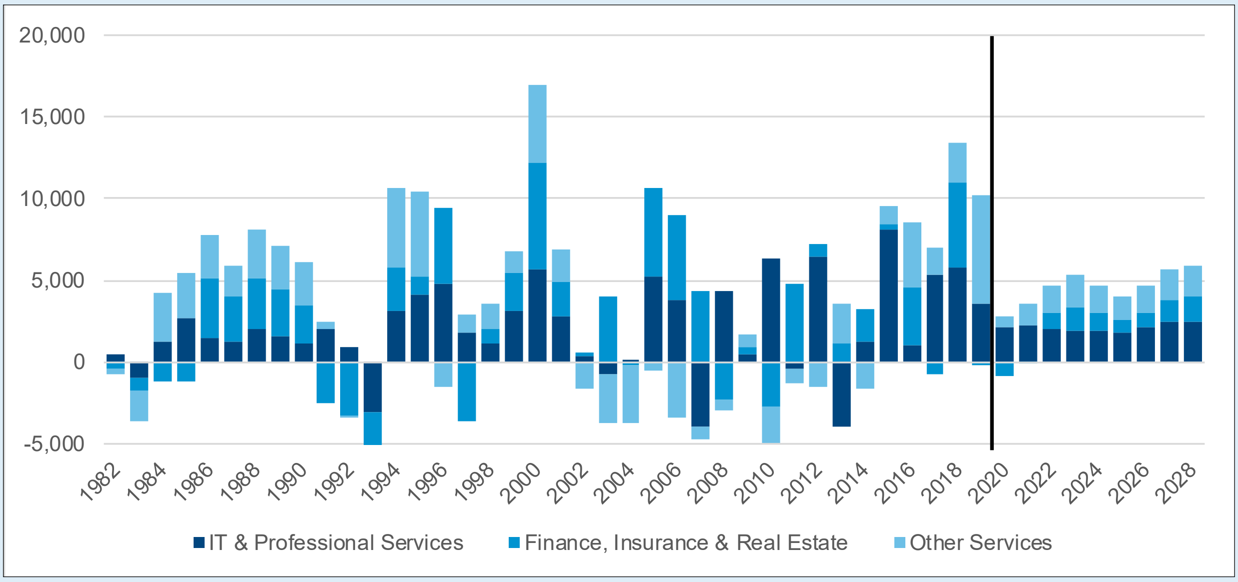
The technology sector will be a key driver of Sydney's employment growth.

> *Our forecasts show that the Sydney CBD is expected to have more workers in the Professional, Scientific and Technical Services than the Finance and Insurance industry.*

Sydney is not only Australia's major globally-connected city but also an emerging global technology and innovation hub. Almost two-thirds of Australia's 100 largest companies (ASX 100) and many Fortune 500 companies are headquartered in Sydney as the city offers one of the most diverse financial eco-systems in the region and access to a deep pool of talent and global capital markets. Every year, the city welcomes over 13,000 new graduates from STEM (science, technology, engineering and mathematics) courses across 11 universities. Sydney's education system ranks amongst the best in the world, housing many globally leading institutions including; The University of Sydney, The University of New South Wales (UNSW), The University of Technology Sydney (UTS), Macquarie University and Western Sydney University (UWS).

The city is home to 60% of Australia's fintech (Financial Technology) companies and 48% of start-ups in the country (Invest NSW). To make Sydney a global innovation and technology hub, the NSW government has embarked on an ambitious program to establish the Sydney Innovation and Technology Precinct in the south of the traditional Sydney CBD grid. Our forecasts indicate that employment in the Professional, Scientific and Technical Services sector in the Sydney CBD is expected to grow by between 23,600 and 35,000 over the next ten years, which is about half of the total white-collar employment growth. Our forecasts show that the Sydney CBD is expected to have more workers in the Professional, Scientific and Technical Services than the Finance and Insurance industry.

GRAPH 5: Sydney CBD White Collar Employment Growth

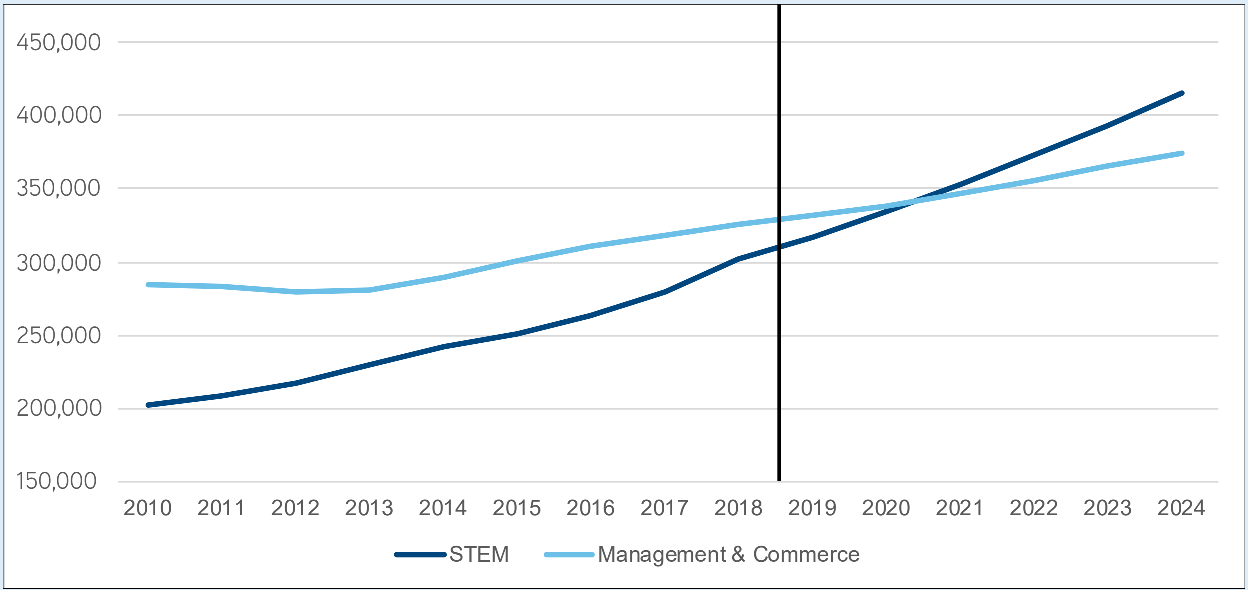


Source: Colliers International

The future growth of tech-related employment is also supported by the number of graduates at Australian universities with STEM (Science, Technology, Engineering, and Mathematics) qualifications. As at 2018, 301,798 students were studying for STEM degrees across Australian higher education institutions, up 8% from the previous year. In contrast, enrollments in Management and Commerce (M&C) courses have increased by only 2% over the past year to 326,062. The number of STEM students is expected to exceed M&C graduates by 2021, according to Colliers International's forecasts. About 60% of STEM enrollments are local students, while only 40% of students currently studying M&C courses are domestic students. Although we understand not all students will eventually work in the same fields as their study, this data gives us a clear indication of where the future of Australian jobs is heading.

> *"The number of STEM students is expected to exceed M&C graduates by 2021, according to Colliers International's forecasts."*

GRAPH 6: Australian Students by Field of Education



Source: Colliers International, Department of Education

4. Demand & supply outlook.

4.1

Demand is driven by strong white-collar employment growth.

Modelling by Colliers International suggests that latent demand for the Sydney CBD will reach around 404,000 to 606,000 sqm over the next decade in a base case scenario assuming a density of between 10 and 12 sqm per worker. In our high case scenario, in which NSW economic growth is increased by 1 percentage point, office space absorption is expected to rise to between 593,000 and 889,000 sqm to support the stronger growth of white-collar employment in the city. However, considering the high level of stock withdrawals, our forecasts show that the Sydney CBD office market will need to deliver gross supply of between 1.0 and 1.5 million sqm to meet forecast demand over the next 10 years.

About half of this demand would derive from the Professional and Technical Services sector, which is expected to show the most robust employment growth in the next ten years. Net take-up by occupiers in the Professional and Technical Services sector is projected to be between 189,000 and 283,500 in our base case and between 283,800 and 425,600 in our high case scenario. A key constraint to this growth is the potential lack of future supply of new office space in the city; especially of the large-floor plate, tech-style campuses that tech occupiers require. The Sydney CBD is an inherently supply-constrained city due to its restrictive planning regime and geographical location, bounded by the Royal Botanic Gardens & Hyde Park to the east, Sydney Harbour to the north and west, and Central Rail System to the south.

TABLE 2: Projected net absorption in the Sydney CBD (July 2019 - July 2029)

Workspace Density	Total Demand		Professional & Technical Services	
	Base Case	High Case	Base Case	High Case
8:1	403,813	592,723	189,008	283,760
10:1	504,766	740,903	236,260	354,700
12:1	605,719	889,084	283,512	425,641

Source: Colliers International

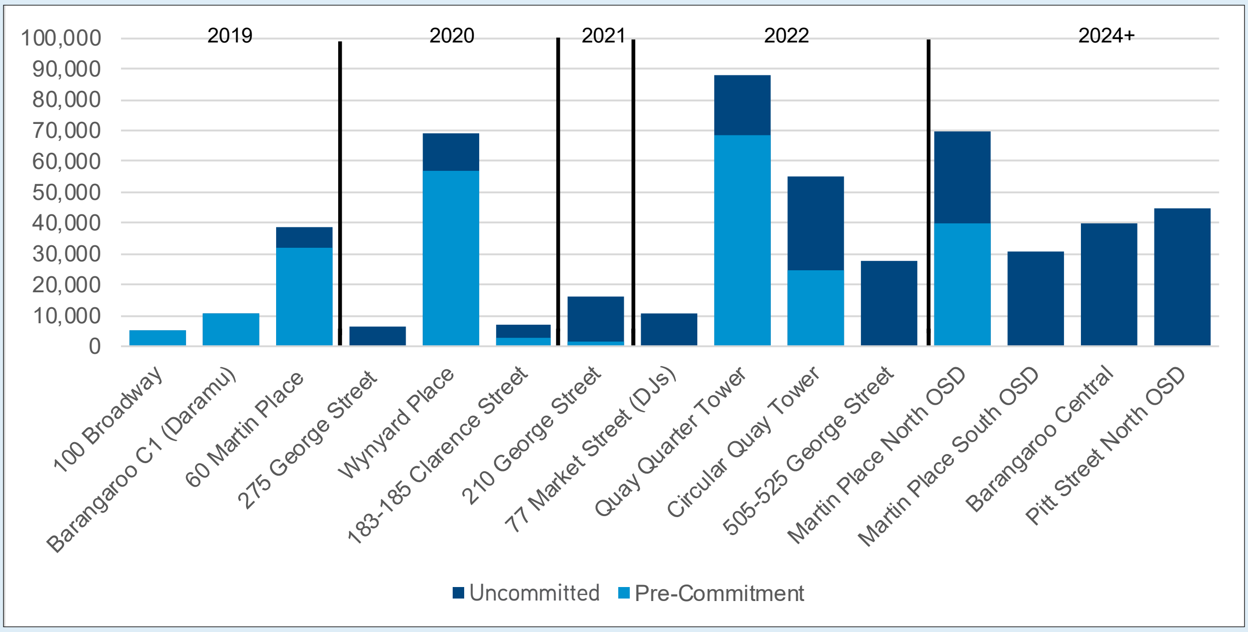
4.2

Supply

The identified pipeline of future new developments in the Sydney CBD (excluding the precinct that is the subject of this report) currently sits at 520,000 sqm. Compared to our forecasted latent demand, we estimate that there would be a supply shortfall of at least 500,000 sqm over the next ten years. The majority of the new additions are tied to government infrastructure developments such as the Barangaroo development and the Sydney Metro project. There are significant limitations on additional development sites in the CBD due to its fragmented land sites. Of the identified developments, about 30 per cent is already or close to being pre-committed. Additionally, as the city continues to go through a comprehensive urban renewal process, we anticipate a high level of stock being withdrawn from the market as older buildings reach the end of their economic life and others are converted to alternative uses. Over the past 20 years, for every 100 sqm of new stock being delivered about 70 sqm of existing office space has been withdrawn from the market. The withdrawal rate has accelerated in the past decade, with the quantity of stock withdrawals equating to 80% of the volume of new completions.

“Over the past 20 years, for every 100 sqm of new stock being delivered about 70 sqm of existing office space has been withdrawn from the market. The withdrawal rate has accelerated in the past decade, with the quantity of stock withdrawals equating to 80% of the volume of new completions.”

GRAPH 7: New Supply Development Pipeline



Source: Colliers International

> *At the current rate of development, the Melbourne CBD could overtake the Sydney CBD as the largest commercial market in Australia in the next decade.*

The total office floor space in the Sydney CBD has declined from 5,098,358 sqm as at July 2017 to 4,985,833 sqm as at July 2019. Over the same period, the Melbourne CBD saw its stock increased from 4,524,598 sqm to 4,614,349 sqm. At the current rate of development, the Melbourne CBD could overtake Sydney CBD as the largest office market in Australia in the next decade. The high level of stock withdrawals in the Sydney CBD can be attributed to a couple of factors;

1. The Sydney CBD office market has a high level of secondary stock, which is of older age and lower quality. About 40% of the total office space in the Sydney CBD is secondary grade (2.0 million sqm out of a total of 4.98 million sqm). Most of the aged stock is concentrated in the Central office precinct of Sydney, with 54% of its current stock base (364,904 sqm) being secondary. In comparison, the Melbourne CBD only has 33% of its stock in the secondary market.

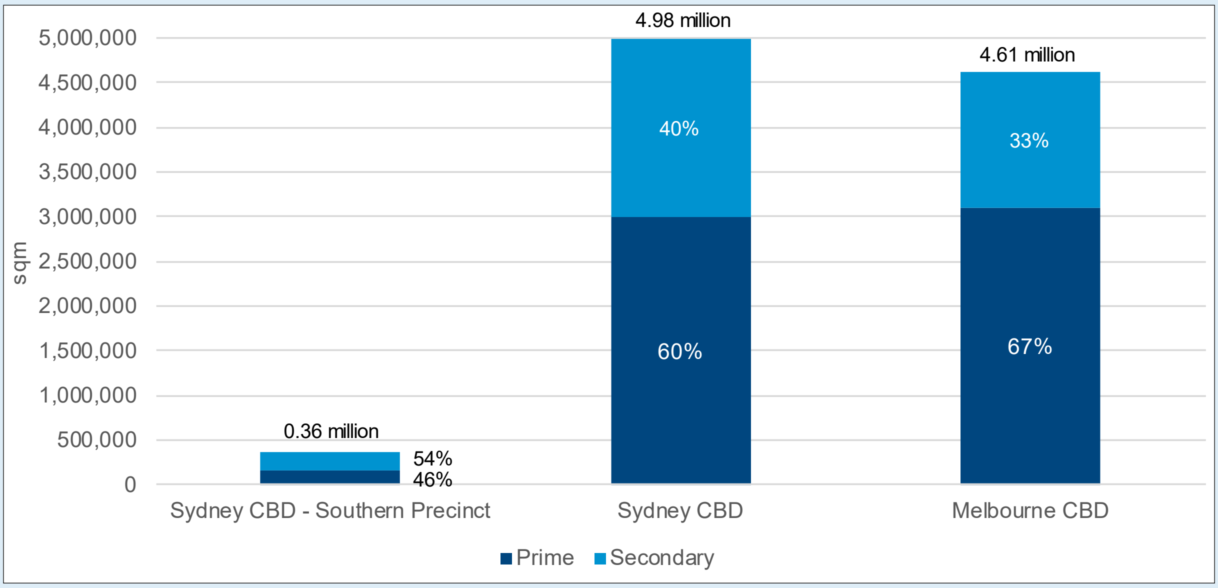
2. There is intense competition for conversion of office space into alternative uses on the back of continued population growth and a booming tourism sector. Notably, about 150,000 sqm of office stock in the CBD has been permanently lost to residential apartment and hotel conversions over the past five years.

3. The Sydney CBD is geographically restrictive with small and fragmented land parcels. As a result, new developments have resulted in a high level of stock being demolished for site agglomeration. Hence the actual net supply is much lower than the headline figure of gross additions.

4. The construction of the Sydney Metro project has resulted in a significant loss of commercial floor space. About 60,000 sqm of existing office space was taken offline to give way for the new metro stations. Most of this floor space will be returned to the market from 2024 via over station developments.

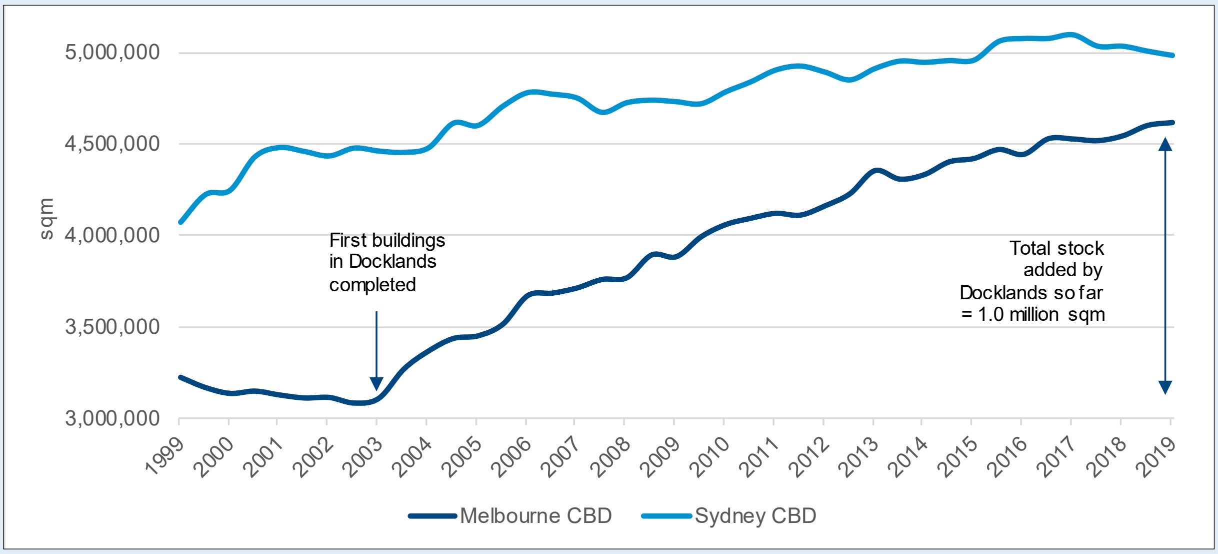
As a result of the substantial stock withdrawals amid limited new supply, the Sydney CBD is currently experiencing an acute shortage of stock. With the vacancy rate at 3.7% as at July 2019, the current availability level is almost half of the 20-year average of 7.2%, which is generally considered the level needed for the market to achieve the state of equilibrium between supply and demand. Colliers International predicts that the vacancy rate will continue to trend down to around 3.0% in 2020. Beyond 2021, despite the projected increase in new developments, the market is anticipated to remain under-supplied, with the vacancy rate remaining below its equilibrium level.

GRAPH 8: Prime vs Secondary Office Stock



Note: The Sydney CBD number includes the Southern CBD Precinct stock number.
Source: Colliers International

GRAPH 9: Sydney vs Melbourne CBD Office Stock



Source: Colliers International

The Current Nature of the Southern Precinct of the Sydney CBD

The Southern Sydney CBD office market precinct is defined by the Property Council of Australia as the Southern precinct of the Sydney CBD and is located at the southern end of the commercial core of the Sydney CBD. The development straddles the eastern border of this precinct. There is a total of 364,904 sqm of office space as at July 2019, accounting for just 7.3% of the total stock in the Sydney CBD (4,985,833 sqm). The precinct is characterised by a proliferation of residential, mixed-use, small land parcels and fragmented ownership. These conditions have provided significant challenges and limitation for the expansion of the CBD market to the south due to the lack of large development sites needed to deliver large-scale office projects.

There are no premium office buildings in the Southern CBD Office precinct and more than half (54%) of the current stock base is of secondary grade. Of the 167,927 sqm of A-Grade stock, the majority of it was built before or during the 1980s with typical floor plates of less than 1,500 sqm. These buildings also typically have multiple columns, making them less than ideal for larger occupiers and corporate headquarters. There is also a high level of strata land parcels scattered across the precinct hindering the ability to agglomerate development sites. More than 7% of the current stock in the Southern CBD office precinct is strata office. As a result, the tenancy mix in the vicinity is dominated by small and medium-sized tenants and boutique legal firms. The most significant occupiers in the market are government departments, which are expected to decentralise to suburban locations in the near future.

The Southern CBD Office Precinct is significantly underutilised compared to the rest of the CBD. Spatially, the precinct spans across circa 561,000 sqm and has a total office floorspace of 364,904 sqm (floor space ratio = 70%). In comparison, the northern core of the CBD covers approximately 2.1 million sqm of land and has 4.6 million sqm of commercial floorspace (floor space ratio = 220%).

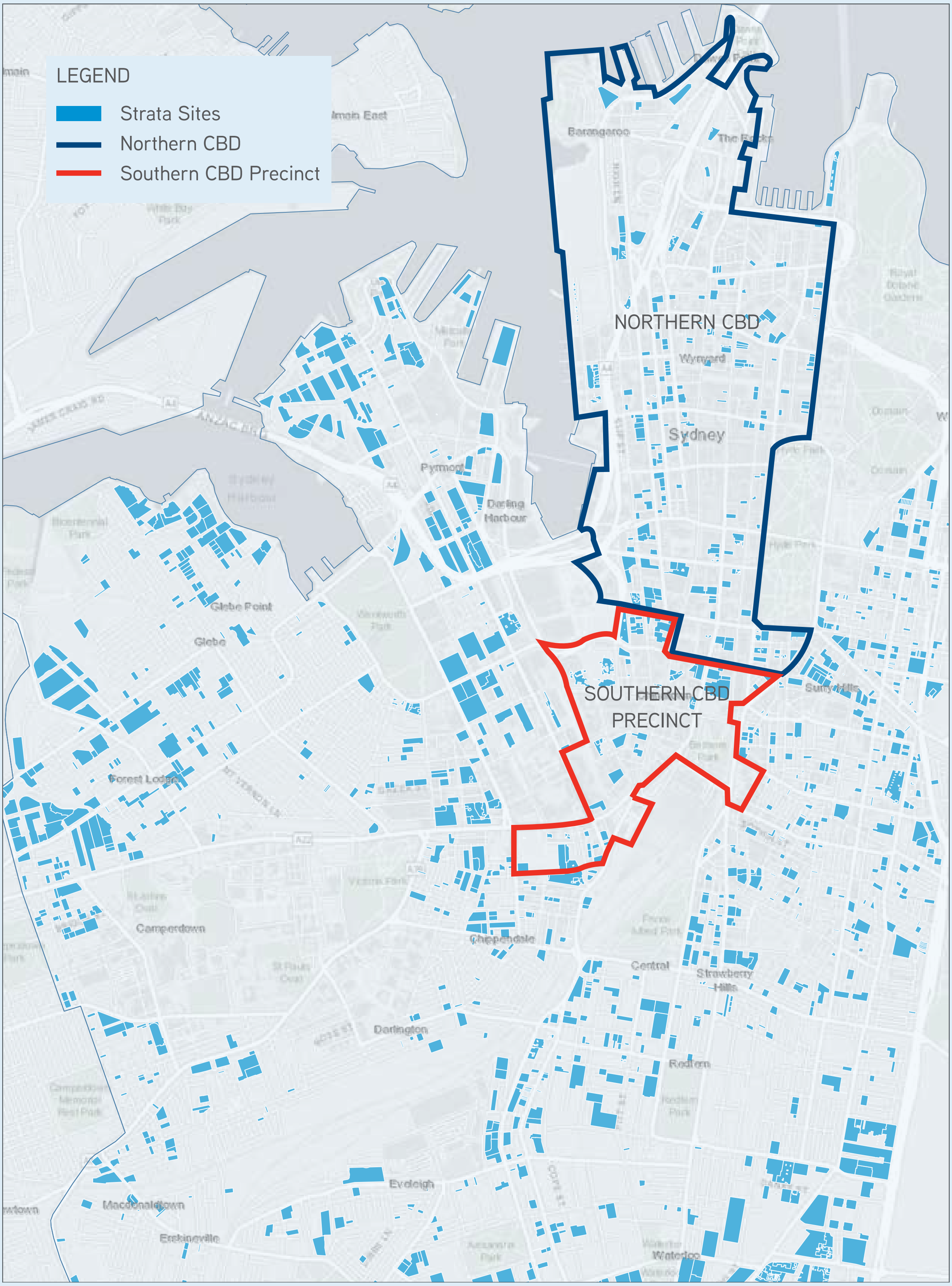
This means the Southern CBD Office Precinct is 70% underutilised compared to the northern core of the Sydney CBD in terms of floorspace per land area. With around 65,950 workers (according to the City of Sydney), the Southern Precinct of the Sydney CBD generates 55% less employment per sqm of land compared to the rest of the CBD.

323 Castlereagh Street, Sydney

320 Pitt Street, Sydney

Centennial Plaza, Sydney

FIGURE 6: The Current State of The Southern CBD Office Precint



*Note: The Southern Precinct is part of the Sydney CBD Office Market as defined by the Property Council of Australia

FIGURE 7: Floorplate sizes in tech precinct

Area (sqm)

- < 1,000
- 1,000 - 1,500
- 1,500 - 2,000
- 2,000 - 3,000
- > 3,000

4.3

Impact of infrastructure development on the Southern Sydney CBD Office Precinct.

> *“Technology and knowledge-based companies have a strong tendency to cluster around transport hubs close to amenities to attract and retain talent.”*

To support economic and employment growth, the NSW government is set to deliver on the most significant infrastructure program in Australian history, with an A$87.2 billion pipeline of infrastructure across the state currently under construction or in planning. A significant proportion of this investment will be concentrated in the Sydney CBD and help to improve connectivity and accessibility for the Southern Precinct of the Sydney CBD. Amongst the mega projects that would benefit the Central precinct are the Sydney Light Rail, the Sydney Metro and the redevelopment of Central Station. The completion of the Sydney Light Rail in 2020 would provide a significant improvement in connectivity between Central Station and Town Hall along with direct transfer to the existing line to Dulwich Hill.

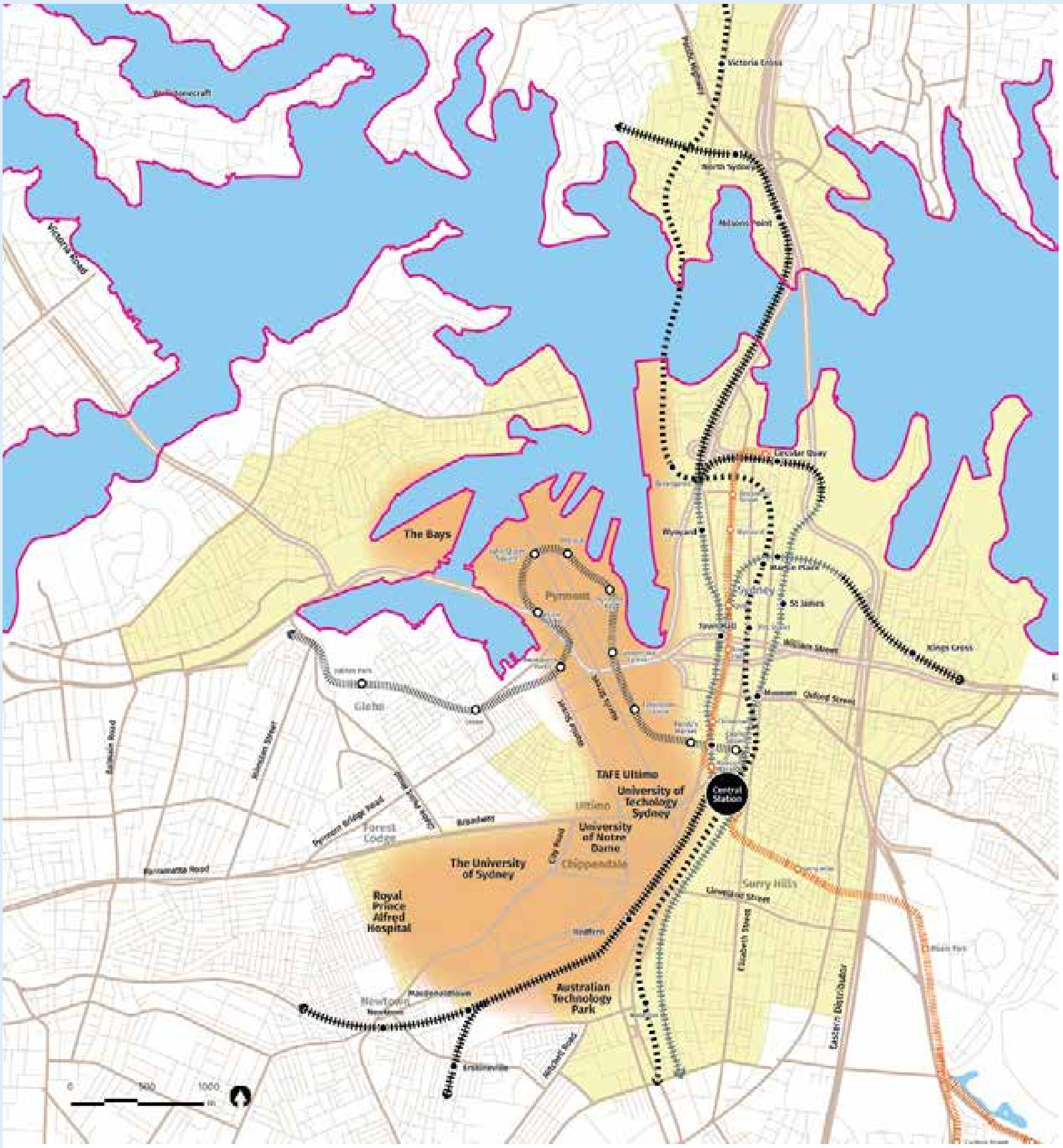
Sydney Metro is expected to be operational in 2024 and would add 31 new metro stations culminating at Central Station, targeting a capacity of 40,000 customers per hour. With indicative times of 15 minutes to Chatswood station and four minutes to Martin Place, Central Station would also undergo a significant redevelopment program. The renewal of Australia’s busiest commuter hub would see Central Station transformed into the gateway to the new Sydney Metro network with the projected growth of people using the station every day to increase from 270,000 to 450,000 following the redevelopment and completion of the station (Sydney Metro).

Our review of previous studies around the world suggests that there are significant value-added effects of urban rail developments on commercial property values. In San Diego County, for instance, commercial real estate within a ¼ mile (400m) buffer zone from commuter rail stations enjoyed an average valuation uplift of 91.1%, and those within ½ mile (800m) gained 71%. Another meta-study analysing 13 locations across the US saw an average value appreciation of 11.2% for assets located within a ¼ mile from transit stations. Similar effects were also found in Dubai (40% uplift for being 1.5km near a new MRT station) and Wuhan, China (16% in the 100m ring and 8% in the 300m radius of the new station).

We also found that the development of new rail transit systems not only improve property values but also enhance business formation and performance in the area. One key example was when the Phoenix, Arizona light rail system opened in 2008, the number of new businesses in the knowledge sector within walkable distance to the new stations increased by a massive 88%, while companies in other service industries increased by 40%. Technology and knowledge-based companies have a strong tendency to cluster around transport hubs close to amenities to attract and retain talent.

Millennial professionals are more likely to live around public transport and demand a high level of amenities and lifestyle facilities. These trends have been apparent across the world in recent years with technology companies increasingly gravitating closer to CBD and urban locations as opposed to the suburban business parks of the past.

FIGURE 8: The Harbour CBD



	Highway		Train Station
	Local Road		Underground Train Station
	CBD & South East Light Rail & stations currently under construction		Waterway
	Inner West Light Rail		Harbour CBD
	Future Metro Station		Innovation Corridor

Source: Greater Sydney Commission | Eastern City District Plan

5. Requirements of occupiers of the future.

5.1

Requirements of occupiers of the future

Colliers International recently conducted a research trip to the San Francisco Bay Area and has observed several key trends in the placemaking of some of the most innovative occupiers in the US. These trends are also consistent with our investigation into thriving innovation hubs around the world such as Silicon Wadi in Tel Aviv Israel, Shenzhen in China or Dublin Docklands in Ireland. These key themes include:

FLEXIBILITY

Tenants are increasingly seeking flexibility and functional efficiency in their physical office space and its layouts. High growth companies, especially in the hi-tech industry, demand a combination of core space plus flexibility to accommodate future growth. Flexible office accommodation should include large uninterrupted floor plates of preferably a 2,000 sqm minimum with well-planned space grids and simplified building specifications.

ACCESSIBILITY

Landlords need to provide 18/7 (18 hours, 7 days) access to buildings and amenities. Technology companies and start-ups are increasingly working across multiple time zones and adopting flexible working arrangements. Additionally, changing working patterns are further facilitated by the participation of a new generation of millennials in the workforce.

GRAVITATION TOWARD THE CBD

Over the past few years, we have witnessed an emerging trend of technology companies moving from suburban business parks toward the CBD or city fringe locations. We have also seen the same trend in San Francisco, where several major technology tenants have moved from Silicon Valley to San Francisco CBD. The reasons for such moves are to be closer to the talent pool, access to amenities, connectivity and housing affordability.

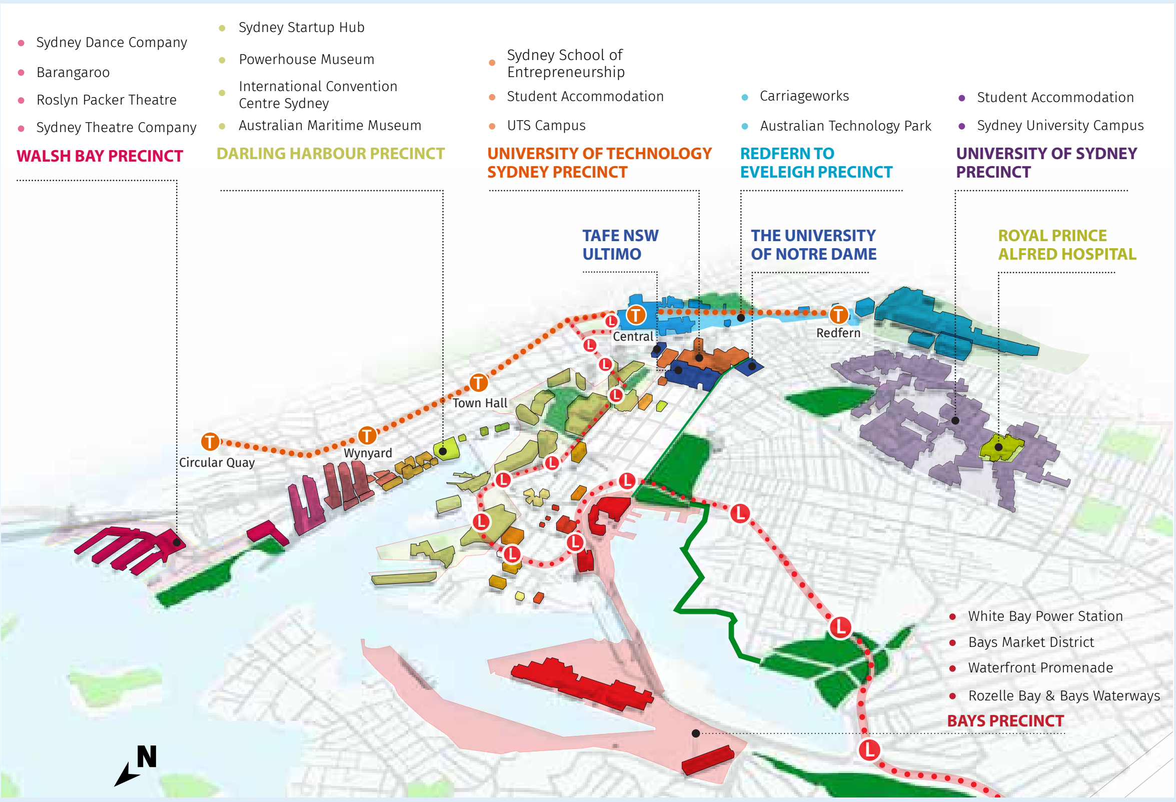
THE RISE OF URBAN CAMPUSES

The gravitation of tech companies toward urban locations have transformed inner city neighbourhoods into urban tech campuses. Examples include Google's Chelsea Market in Manhattan and its new UK headquarters in London, Salesforce Tower in downtown San Francisco and Facebook's urban campus in Manhattan. These campuses require large floorplates of 5,000 sqm or above with internal amenities such as video arcades, gourmet office commissaries, fitness facilities in addition to proximity to bars, restaurants and accommodation.

ACCESS TO UNIVERSITIES

The war for talent is becoming a pressing issue for many knowledge-based industries and companies worldwide. As competition intensifies globally, firms must rely on their innovative workforce to be ahead of their competitors and respond to evolving consumer behaviours. Recruiting and retaining the best employees is of paramount importance in creating an innovative culture in the workplace in response to the changing economic times.

FIGURE 9: Innovation corridor



Source: Greater Sydney Commission | Eastern City District Plan

6. Case Studies.

6.1

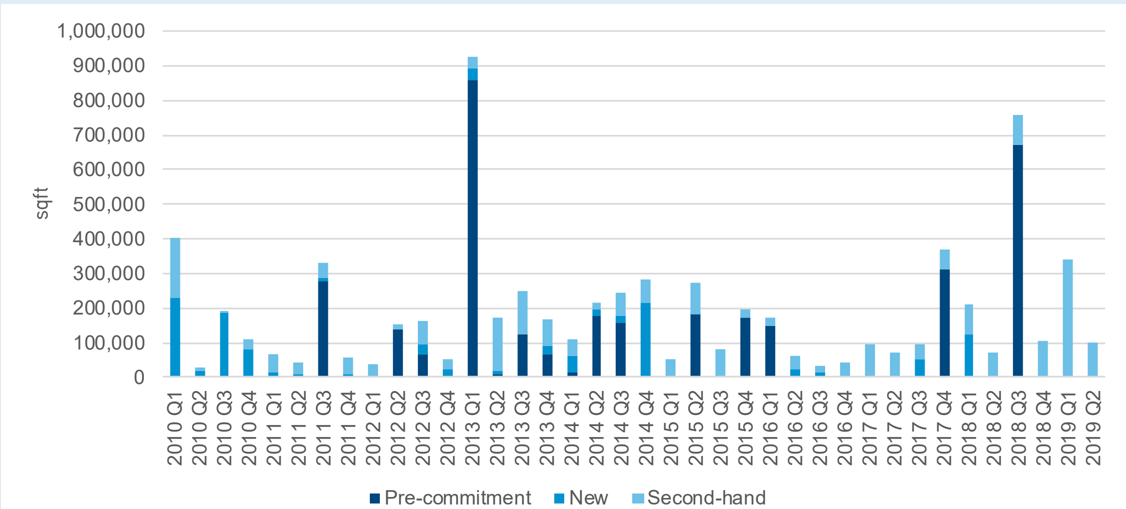
Case Study: King's Cross London

Once a derelict area of industrial warehouses and rail yards, King's Cross has been transformed into one of the most innovative and vibrant commercial hubs in the UK and Europe. Set within 26 acres of parks and open spaces, King's Cross is one of the most significant regeneration projects in the UK at the moment. There is nearly 370,000 sqm (4 million sq ft) of offices built or proposed across more than 50 new buildings. The precinct is well serviced by a vibrant contemporary city quarter with shopping, art galleries, cultural venues, bar, restaurants, homes and education facilities. The upgrade of the transport offering and the soon-to-commence redevelopment of Euston Station to improve existing services and accommodate the new High Speed 2 terminal would help to attract further major tenant relocations into the area.

Despite the vigorous development activity, availability within King's Cross is extremely tight due to the strong demand from the technology and creative industries. International blue-chip occupiers such as Google, Expedia, Samsung, Toyota, Havas have all chosen to locate here with many more to follow such as Facebook, Nike and potentially Sony Music. Google has commenced the construction of a 93,000 sqm (1 million sq ft) urban campus to house its new UK headquarters. Upon completion, the 11-storey "landscraper" building would house up to 7,000 Google employees within state of the art facilities. Besides, Facebook has recently signed for a 57,000 sqm (611,000 sq ft) pre-lease in the precinct. Nike is also reportedly looking to move to the area with a pre-commitment of 5,600 sqm (60,000 sq ft).

According to an independent research study by Regeneris Consulting, the ongoing regeneration of King's Cross is contributing over A$1.0 billion (£600 million) in added value to the UK economy every year. Up to A$5.4 billion (£3 billion) has been invested in construction activity on the site to date. Furthermore, the new commercial precinct is supporting over 30,000 new local professionals with most of them in high-value industries. The scheme has also delivered 900 new homes, which resulted in additional spending power of A$138 million (£77 million) per year from the new residents. The increased local population has supported over 200 services jobs in the local area and generated $2.5 million (£1.4 million) in additional council tax per year. Colliers International research also shows that King's Cross has outperformed other inner London sub-markets in terms of employment growth and uplifts in commercial and residential values.

GRAPH 10: King's Cross Demand Take-up



Source: Colliers International

FIGURE 10: The King's Cross Precinct

1	Google	6	BRAINPOOL	11	dazzle
2	facebook	7	TOYOTA connected	12	MUSO
3	UNIVERSAL MUSIC GROUP	8	previse	13	ARK coworking
4	SAMSUNG	9	THE FRANCIS CRICK INSTITUTE	14	expedia group
5	DeepMind	10	The Alan Turing Institute	15	AUTOMATA

6.2

Case Study: Docklands Melbourne

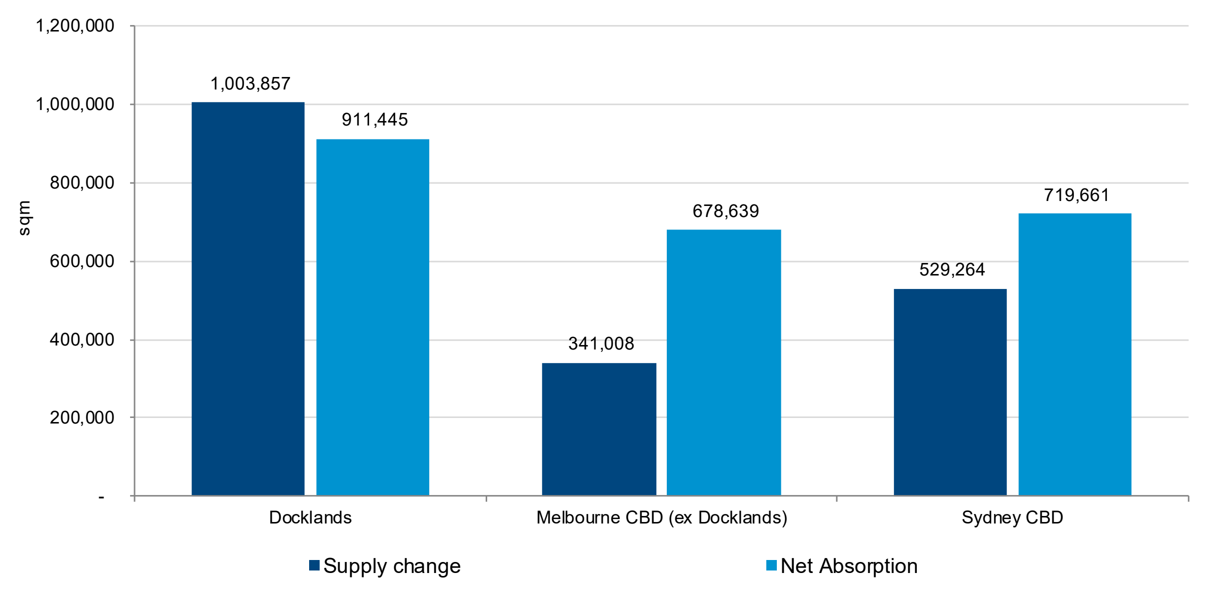
The first office buildings in the Docklands precinct of Melbourne completed in late 2003. These were the NAB building at 800 Bourke Street (circa 56,000sqm) and 700 Collins Street (circa 32,000sqm) which was pre-committed by Medibank. Prior to 2003, Docklands was an effectively abandoned dock area. Since this time, Docklands has grown to be the second largest precinct in the Melbourne CBD, and by July 2019 has grown to be a 1 million sqm office precinct.

Net absorption in the Melbourne CBD since 2004 has totaled 1.59 million sqm, or an average of almost 100,000sqm per annum. Almost 60% of Melbourne's net absorption since 2004 has occurred in Docklands. In comparison, the Sydney CBD has generated additional occupancy of only 720,000sqm over the same time period – the result of significant withdrawals of office stock over this time.

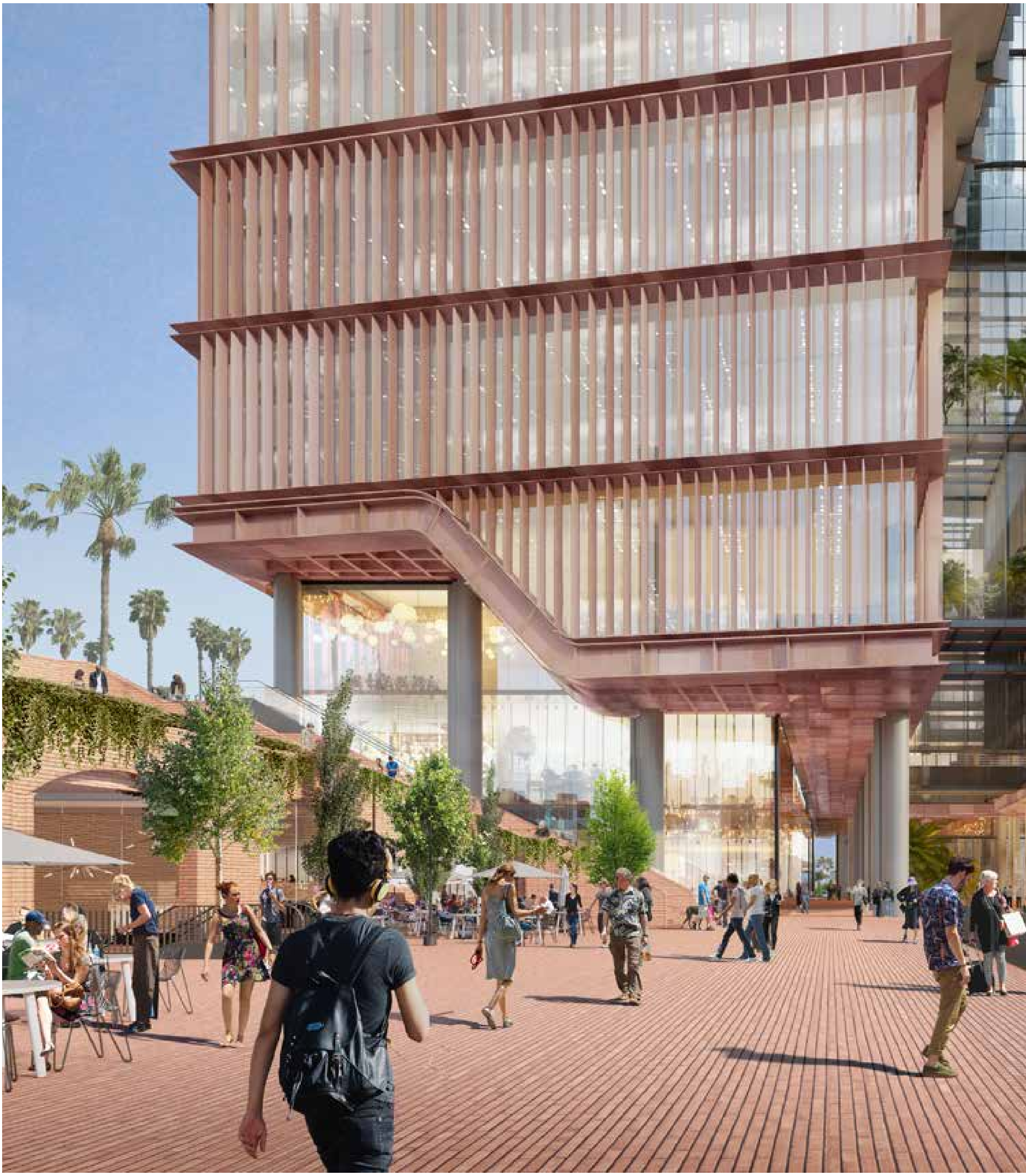
The impact of Docklands on the Melbourne CBD has been profound. Not only has the city grown by 1.345 million sqm over this time, employment in the CBD is estimated to have increased by 115,000 jobs. Over the same time period, estimated white collar employment in the Sydney CBD has increased by 78,000 jobs[1]. Without Docklands, Melbourne would have faced even bigger supply constraints than Sydney, as the traditional Melbourne grid has only grown by 340,000 sqm, with net absorption of 687,000 sqm, since 2004. Vacancy in the Melbourne CBD is currently the lowest in the country – at 3.3%, and the Docklands precinct maintains near full capacity, with 0.6% of space vacant, or only 5,675sqm, showing that a strong supply pipeline of appropriately sized and located stock is more than able to be met with demand in our major CBDs.

[1] Deloitte Access Economics, employment forecasts June 2019

GRAPH 11: Supply and Net Absorption, July 2003 to July 2019



Source: Colliers International, PCA OMR July 2019



7. Impacts of the development on the Sydney office market

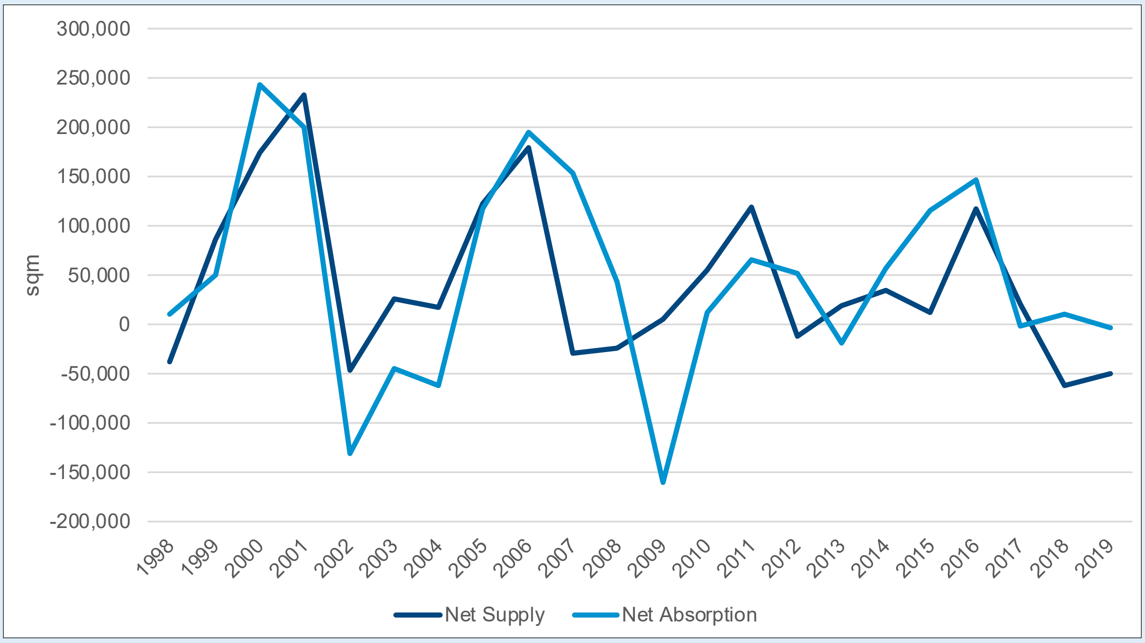
7.1

Impacts of the development on the Sydney office market

The Southern Precinct of the Sydney CBD is in a unique position to become Australia and the Asia Pacific's most innovative commercial hub. It is well serviced by future infrastructure and amenities that will meet the requirements of the occupiers of the future. With convenient access to Australia's leading universities, a large pool of STEM graduates, an abundance of entertainment options, affordable living options and a vibrant culture of innovation and creativity, the precinct will undoubtedly be one of the most preferred locations for start-ups and technology companies. However, the current lack of large-floorplate office developments offering workspace flexibility and urban campuses remains the critically missing factor that could hinder future demand.

As such, the development would provide the opportunity for the Sydney CBD to extend its office market to Central Station and would be a crucial component to ensure the success of the proposed Innovation and Technology Precinct. A development of this significance would not only attract global companies to Sydney but also help to retain existing occupiers that could potentially be lured by other competing commercial markets in Australia and regionally if there is not enough supply to suit their growth. Our analysis shows that there is a positive correlation between net supply and white-collar employment in Sydney. An increase in new supply that meets the needs of Sydney's future workforce would enable employment growth and entice inbound tenant migration from other markets. As a result, Colliers International believes that the development would have a significant and positive impact on the Sydney economy and help to maintain the city's competitiveness globally.

GRAPH 12: Supply Demand Correlation



Source: Colliers International

8.0

Contact us.

Anneke Thompson
National Director
Research
+61 412 581 647
Anneke.Thompson@colliers.com

Alex Pham
Director
Research
+61 433 779 984
Alex.Pham@colliers.com

Simon Hunt
Managing Director
Office Leasing
+61 411 156 686
Simon.Hunt@colliers.com

Cameorn Williams
National Director
Office Leasing
+61 412 691 765
Cameron.Williams@colliers.com

Frank Sassine
National Director
Office Leasing
61 408 487 854
Frank.Sassine@colliers.com

www.colliers.com.au