

SYDNEY OFFICE MARKET 'MEXICAN STANDOFF' TO EASE

The 'Mexican standoff' between purchasers and vendors in Sydney's CBD office market should see some improvement in 2009 on the back of greater acceptance of the realities of the global financial crisis, according to Savills.

Savills latest Sydney CBD Office Market Overview highlights the credit and confidence issues that have dramatically reduced the level of transactions and leasing demand.

The Sydney CBD office market is currently experiencing the lowest levels of transaction activity in the last 10 years. The 2008 year saw the office investment market turn from fierce competition between trusts and funds to purchase limited stock, to an influx of stock being offered to the market with few buyers, the Savills research report states.

The CBD only witnessed four sales of more than \$10 million – 541 Kent Street at \$12.6 million; 46-48 York Street at \$18 million; 66 Clarence at \$60 million; and 44 Martin at \$82.8 million. All of these properties were sold to private investors and the last two properties were sold at a reported yield of 7.25% each.

"Both purchasers and vendors were in a 'Mexican standoff' in 2008, with a huge spread seen between buy and sell offers. Savills believes this situation should rectify itself somewhat on both sides of the equation during 2009," said Michael Andrews, Savills NSW Managing Director.

"Purchasers, particularly those who have to answer to investors domestically and overseas, still do not believe the market has reached the bottom of the cycle. They will hold off until they are confident the market has done so, or an offer is so attractive they believe they can't lose. Many deals now under negotiation are being done so with this in mind.

"Vendors, however, are keen to secure some of the limited funds available in the current market and are prepared to negotiate today a transaction that will occur in six to 12 months at yields reflecting the bottom of the market."

Mr Andrews said the global financial crisis is now a reality accepted by all, owners now realise 2007 yields are simply not achievable, and those who find it necessary to sell to meet capital requirements or debt obligations will be forced to meet prevailing market rates.

He said prospective vendors and purchasers display a wide disparity of opinion on yields, with many investors now concentrating on Initial Yields as the driving force for investment rather than focusing on Total Returns or Market Yields. Further reductions in the official interest rate are expected to place even greater emphasis on the Initial Yield of investments over the next 18 months.

"For purchasers, interest costs have reduced significantly while yields have expanded. In certain cases quality property may be attained with a positive spread to debt costs – which is the first time this has occurred in over a decade," he said.

"Further, with risk free returns from cash now significantly lower than in 2008, investors requiring adequate returns will be enticed away from cash."

Please note:

Savills is a global publicly-listed property solutions company providing services in sales, leasing, valuations, project management, corporate real estate, marketing and all aspects of commercial and retail property management.

According to Savills, these purchasers are seeking quality investments, with long WALEs (Weighted Average Lease Expiry), strong covenants and little need for capital works. Such properties are reluctantly and rarely offered to the market.

The lack of construction activity in the pipeline means office vacancy will only be dictated by negative absorption as a result of shrinking tenant demand and not hoards of construction.

“Once tenant demand recovers, in the medium term, we may be faced with a lack of supply similar to the situation faced late 2007,” the Savills research report notes.

In the year to December 2008, Savills identified 219,813 sq m of office leases in the Sydney CBD. This is down 26% on the 12 months prior, and down on the five-year average of 324,788 sq m.

Absorption in the Sydney CBD has felt a more rapid and stronger fall when compared to other CBDs due to a higher concentration of finance and insurance firms shedding staff to cope with the changed business conditions.

Savills previously expected the 2007 to 2011 years to show very strong growth in effective rentals as tenants continue to see their leasing options rapidly erode. However, the market has now turned on its head, with the advent of negative net absorption.

The downturn continues to place pressure on companies to save money by reducing staffing and accommodation costs. Recovery in the office market, like the remainder of the economy, is not expected to commence until late 2010.

“Face rents are expected to remain steady. However, we are beginning to see effective rents fall as incentives rise. Effective rents will continue to erode whilst there is sublease space on the market, and landlords will increase incentives to secure tenants rather than risk long term vacancy in their portfolios,” according to the Savills report.

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