RESEARCH INSIGHT

SYDNEY CBD

OFFICE & HOTEL OWNERSHIP DECEMBER 2016

Key Facts

Offshore buyers have acquired 41% of the total office transaction by value in the Sydney CBD since January 2016.

32.9% of the CBD office stock by NLA is under foreign ownership as at November 2016, up from 32.2% in November 2015.

Conversion of office buildings has been the primary source of new supply of hotel rooms in the CBD over the past 12 months.

Offshore investors hold 87.6% of 4 & 5 star CBD hotel rooms as at November 2016.

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Sydney continues to strengthen its position as a global city and a key target for international investors, with buyers from North America and Greater China trumping other offshore groups for ownership of CBD office and hotel assets.

Overview

Despite some moderation in the total transaction volume during 2016 due to the lack of on market opportunities, the Sydney CBD remains an investment hotspot for offshore investors. Boosted by a relatively strong service-oriented economy, an improved leasing market and a booming tourism sector, Sydney presents itself as a safe haven with attractive return metrics for global investors amid rising economic and political uncertainties worldwide.

The total investment volume into the Sydney CBD office market so far this year has reached $2.89 billion, down 55% YoY. Of this amount, 41% or $1.18 billion worth of office towers has been acquired by offshore buyers. In the hotel market, despite the lack of transaction of existing hotels in the past 12 months, offshore investors continue to penetrate the tightly-held market by converting secondary office buildings into hotels. Almost all office-to-hotel conversions in the Sydney CBD in the past 12 months are owned by foreign groups.

North America and Greater China remain the largest foreign owners of CBD office buildings as at November 2016 with their ownership growth accelerating at the expense of local groups. While North American investors largely target core and core-plus assets, the majority of investors from Greater China focus their attention on value-added opportunities, particularly those with redevelopment or repositioning upside potential. With respect to local investors, unlisted property funds remain the largest owners in the Sydney CBD by both NLA and value, followed by A-REITs.

In the hotel sector, Asia-based investors continue to dominate the market with Singapore being the majority owner of 4 & 5 star hotel rooms in the Sydney CBD. Other Asian groups from China, Hong Kong and Malaysia have also recorded strong growth in ownership over the past 12 months. With limited greenfield developments, new supply of hotel rooms this year has come primarily from conversions of commercial buildings.

SYDNEY CBD OFFICE

As at November 2016, Knight Frank is tracking $69.5 billion worth (up 23% YoY) of investment grade office buildings in the Sydney CBD, covering 4.60 million sq.m of NLA. The total office stock has increased by 5.15% YoY with 225,335m^2 added to the CBD since January 2016, deriving entirely from the completion of the two Barangaroo Towers (T3 and T1), 200 George Street (the new EY Centre) and One Wharf Lane (161 Sussex Street).

Offshore investors continue to foray into the Sydney CBD office market via acquisition of prime office developments. Of the new supply this year, 63% by NLA is owned by foreign groups. Those include Lendlease's offshore co-owners of the Barangaroo towers; the Canadian Pension Plan Investment Board (CPPIB) (50% in T3), Dutch pension fund APG (10% in T3), the Qatar Investment Authority (37.5% in T1) and an undisclosed institutional investor based in Asia (25% in T1) as well as the Singaporean owner (M&L Hospitality) of One Wharf Lane (161 Sussex Street).

Other prime acquisitions by offshore investors over the past 12 months include global fund manager Morgan Stanley Real Estate Investing (MSREI) buying the One Shelley Street tower in a joint venture with Charter Hall, Deutsche Bank acquiring 149-151 Castlereagh Street on behalf of a German institution and Hong Kong-based PAG purchasing a 50% stake in 60 Margaret Street from MTTA Super.

While a large portion of offshore demand continues to chase CBD core assets, secondary properties with redevelopment or repositioning opportunities have also received rising offshore interest, particularly from Chinese developers. Recent examples include 210 and 220 George Street sold to China's Poly Real Estate and 71 Macquarie Street acquired by Beijing-based Macrolink in a joint venture (JV) with Melbourne-based Landream. 333 Kent Street has also been picked up by China's Bridge Capital, who plans to redevelop the site in partnership with local developer iProperty.

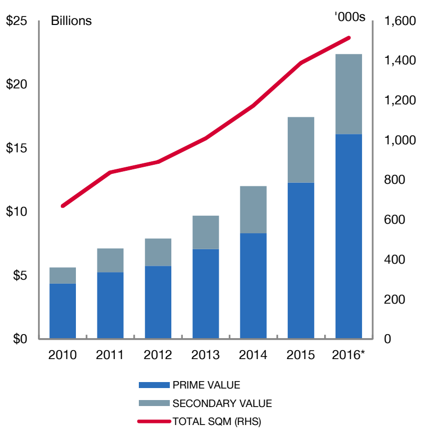
These deals have seen offshore ownership of Sydney CBD office buildings increasing to 32.9% of the total NLA as at November 2016, from 32.2% last year and 16.7% in 2010. By area, offshore owners currently have direct control of 1.51 million sq.m of office space across 77 buildings, or an equivalent of $22.0 billion in value (32.2% of the total value).

As at November 2016, Canada is the largest offshore owner of CBD office assets with a market value of $4.66 billion, followed closely by Singapore with $4.63 billion in holding. The strong ownership growth of Canadian investors has taken the combined value of North American groups (Canada and the US) to $6.58 billion, up by 19.6% YoY. While North American groups remain the dominant owners by total value, investment from Greater China (China and Hong Kong) has seen the strongest annual growth as at November 2016, up by 23.1% YoY to $6.42 billion.

While foreign ownership has increased at a faster pace, local investors remain the biggest owners of Sydney CBD office buildings as at November 2016 with 3.09 million sq.m under direct control or $47.5 billion in value. Unlisted property funds own more office space in the Sydney CBD than any other local groups, with more than 1.25 million sq.m or $2.0 billion in assets. This has taken the total ownership of Australian institutions (including unlisted funds, A-REITs and super funds) to 2.47 million sq.m or $40.1 billion.

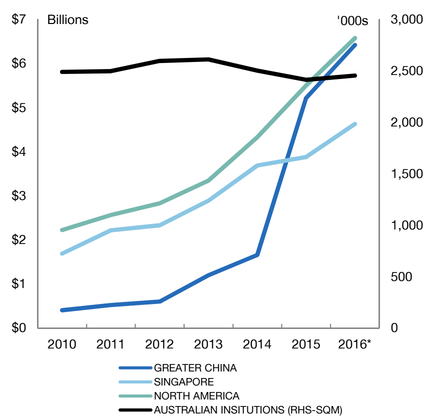
Looking forward, there will be limited supply of new office space over the next three years (Figure 3), with the short term supply pipeline dominated by two listed groups; Investa (151 Clarence Street—2018 and 50% in 60 Martin Place—late 2019) and Lendlease (Darling Square—2018). Beyond 2020, local groups will continue to dominate the new supply pipeline with major owners including AMP Capital (Quay Quarter Sydney—2020 and 20% of Darling Park Tower 4—2021+), Mirvac (55 Pitt Street—2020), Investa (50% of 33 Bligh Street—2020+) and Lendlease (Circular Quay Tower—2021+). Major offshore developers will include Canada's Brookfield (Wynyard Place—2020 and 30% of Darling Park T4—2021+) and China's Poly Group (redevelopment of 210 & 220 George Street—2021+).

FIGURE 1
Sydney CBD Office Offshore Ownership
Total Value & SQ.M by Grade, Nov 10 to Nov 16



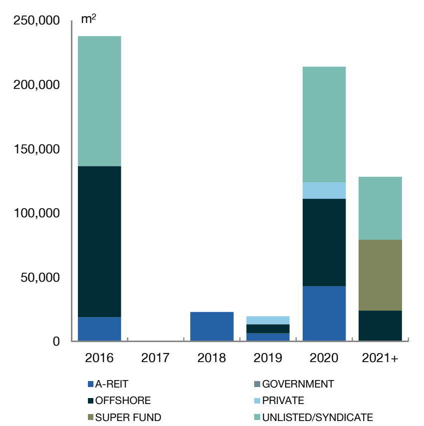
Source: Knight Frank Research
*YTD to November

FIGURE 2
Sydney CBD Office Ownership by Value (Offshore) & SQ.M (Aust^)
Selected Country/Region, Nov 10 to Nov 16



Source: Knight Frank Research
*YTD to November ^Australian Institutional

FIGURE 3
Sydney CBD Office Development Pipeline
By Ownership Type, 2016-2020+



Source: Knight Frank Research
Note: Excludes refurbishment/backfill space

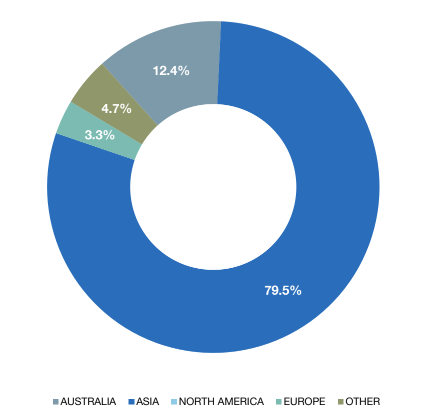
SYDNEY CBD HOTELS

Offshore investors continue to outbid local players in the 4 & 5 star hotel market in the Sydney CBD. As at November 2016, offshore hoteliers control 87.6% (9,711 rooms) of the total number of 4 & 5 star hotel rooms in Knight Frank's database. Among the offshore groups, Asia-based investors are the biggest owners as at November 2016 holding 79.5% (8,815 rooms) of the total number of hotel rooms, up from 77.5% a year ago and 66.7% in 2010.

Singaporean investors top the ownership list of Sydney CBD hotels, with 28% of market share (by rooms) or 3,110 rooms. China and Hong Kong-based investors have the fastest expansion of their hospitality footprint, rising from 1,991 rooms (18% market share) in November 2015 to 2,163 rooms (20%) in November 2016. On the other hand, local ownership remains unchanged over the past 12 months at 1,375 rooms (12% share).

While 2015 marked a buoyant year of investment activity in the Sydney CBD hotel market with a number trophy transactions such as the Westin Hotel, the Hilton and the Sheraton on the Park, the market since the beginning of 2016 has been characterised by a distinct lack of stock available. The only major transaction of a completed hotel (4 & 5 stars) so far this year was the 192-room Vibe Hotel Sydney (111 Goulburn Street) sold by Toga Far East Hotels (TFE Hotels) to Singapore's Far East Organization for $89.6 million.

FIGURE 4
Sydney CBD Hotel Ownership
By Region, Nov 16 (4&5 Star Hotels)



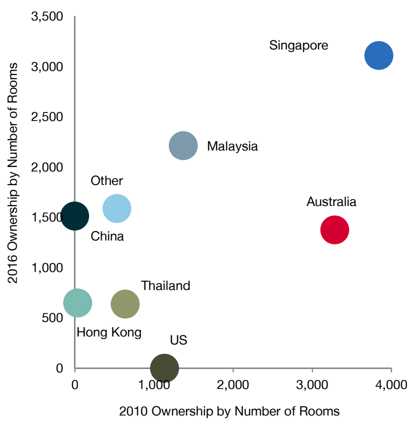
Source: Knight Frank Research

The limited opportunity to purchase existing hotels has resulted in secondary office buildings being bought for conversion into hotels. Major conversions over the past 12 months include the 172-room Primus Hotel Sydney (339 Pitt Street) owned by China's Greenland Group, the 280-room Tank Stream-St Giles Premier Hotel (97-99 Pitt Street) owned by Malaysia's IGB Corp and the boutique 64-room Megaboom City Hotel (93 York Street). However, hotel room growth was neutralised by the closure of the Menzies Sydney Hotel (446 rooms) by Bookfield to give way for the office and retail development of Wynyard Place.

The largest hotel development site deal so far this year was the sale of the W Hotel site in Darling Harbour (formerly the Ribbon) by local developer Grocon to a Chinese investor, the Zhengtang Group. The proposed development will include a 402-room hotel operated by Starwood and 159 luxury residences. Frasers Property is also reportedly in exclusive negotiation with an offshore investor to sell their proposed Four Points by Sheraton Hotel in Central Park, Broadway (in one line with a 5,500m^2 office complex called One Hundred Broadway). The 279-room hotel development is scheduled to be completed in 2018.

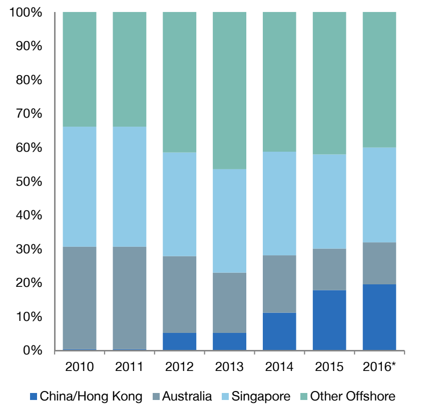
The supply pipeline of new hotels in the Sydney CBD over the next two years will be dominated by offshore groups and local privates. The first half of 2017 will see construction completed at two hotels owned by Singaporean M&L Hospitality Group; the 222-room extension of the Hyatt Regency Sydney Hotel (161 Sussex Street) and the 65 Sussex Street Hotel featuring 186 rooms. Completion of Jerry Schwartz's Sofitel Darling Harbour Hotel (616 rooms) is expected in H2 2017.

FIGURE 5
Change in Sydney CBD Hotel Ownership
By Country, Jan 10 & Nov 16 (4&5 Star Hotels)



Source: Knight Frank Research

FIGURE 6
Sydney CBD Hotel Ownership (%)
By Country, Nov 10 - Nov 16 (4&5 Star Hotels)



Source: Knight Frank Research
*YTD to November 2016

Beyond 2018, the Sydney CBD market is set to see a pick up in new hotel supply stemming from a number of major hotel developments by both offshore and local investors. Those include Beijing Capital's Crowne Plaza Hotel (60-68 Bathurst Street) with 152 rooms to be opened in 2019, Wanda's 176-room Vista Hotel (1 Alfred Street) coming online in 2020 and James Packer's 323-room Crown Resort Barangaroo to be opened in early 2021.

There are also a number of heritage listed buildings in the CBD earmarked for future hotel redevelopment with timing yet to be confirmed. Singaporean Pontiac Group has recently lodged a DA to transform the historic "Sandstone Precinct" (22 & 35 Bridge Street) into a hotel with up to 254 rooms. The City Tattersalls Club is also seeking approval for the redevelopment of their heritage-listed Tattersalls Club Building (202-204 Pitt Street) into a mixed -use complex containing a 100-room hotel. The 333 Kent Street building (built circa 1870), recently acquired by iProperty and Chinese fund Bridge Capital, is also earmarked for potential hotel conversion of 179 rooms.

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Outlook

- In the office market, the lack of prime opportunities in the CBD is expected to be maintained over the next 12 months. As inbound capital continues to flow in, we anticipate offshore demand to spillover to the suburban and secondary markets. With improving leasing fundamentals and relatively attractive pricing metrics, non-core assets will be an attractive proposition to both offshore and local buyers over the next 12-24 months.

- For the hotel market, the office-to-hotel conversion trend is expected to be maintained over the next two years, with a number of deals already in the pipeline. Development site sales and quality hotel assets in suburban locations are also expected to see increasing demand from offshore groups seeking to enter the market.

- With many requirements remaining unsatisfied, Chinese investors will continue to be the major source of inbound capital into the Sydney CBD over the next 12 months, while North American and Singaporean groups are also expected to maintain their ownership positions in both office and hotel markets.

- Capital partnering will be a key strategy for the new entrants in the coming years, particularly those seeking access to the suburban and secondary markets, which require greater local knowledge and development expertise. Not only the local fund managers but also foreign groups who have established themselves in the market will act as the local hubs for future inbound capital.

Methodology:
This analysis collects and tabulates data based on direct ownership of specific assets. The analysis does not specifically include additional offshore capital that may have been invested indirectly via capital partnering initiatives, investment into platforms and listed securities. A recent example of this is the DEXUS and CPPIB acquisition of the Commonwealth Property Office Fund (CPA).
Asset acquisitions are only included in the database at project completion eg Barangaroo Tower 2.

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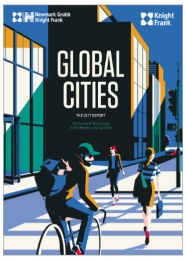

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