RESEARCH

SYDNEY CBD

RETAIL MARKET BRIEF AUGUST 2015

Key Facts

The vacancy rate in the Sydney CBD retail Core has declined to 3.3%, down from 4.1% 18 months earlier

The growing presence of international retailers has forced existing retailers into secondary locations where vacancies previously existed

The Sydney CBD retail Core remains dominated by clothing, footwear & soft goods retailers (36.9%)

Significant capital remains in the market with retail strata sales over the first half of 2015 totalling $66.1 million

LUKE CRAWFORD
Senior Research Analyst

Follow at @KnightFrankAu

International retailers continue to have a major bearing on the Sydney CBD retail market, with a clear preference for large super prime space. This has forced other retailers to look further afield for suitable options.

Retail Overview

House prices continue to have a major bearing on the NSW retail market as a rise in household wealth has supported sustained high levels of retail sales growth. Following a relatively weak Christmas trading period, retail turnover has improved over the six months of 2015 to record annual growth of 6.7% in the 12 months to June 2015. Also contributing to the recent improvement was the February and May interest rate cuts and weakening petrol prices (despite the recent rise), both of which increased household spending capacity.

Despite some recent stabilisation, the decline of the Australian Dollar is supporting local retailers through a combination of increased tourism numbers and less online purchases offshore by consumers. The latter is highlighted by a moderate slowdown in online retailing. According to the NAB Online Sales Index, May 2015 online sales showed annual growth of 9.0%, down from 14.3% in September 2014.

For the Sydney CBD, the continued arrival of international retailers, particularly in the form of 'fast fashion' from the likes of Uniqlo and Forever 21 has supported tenant demand over the past 12 months. With domestic expansion prospects in Europe and North America becoming increasingly limited, the overall attractiveness of the Australian market for these retailers is favourable, supported by a resilient local economy and high discretionary spending. Looking ahead, the continued rollout of apparel/footwear retailers is expected to persist, following in the footsteps of H&M and Zara who continue to increase their presence across the country. However, for the Sydney CBD, the next two to three years is likely to be characterised by the influx of luxury retailers.

Knight Frank Research has completed its 2015 Sydney CBD Retail Core survey which highlights vacancy and tenancy mix trends across the precinct.

SYDNEY CBD RETAIL CORE SURVEY

Vacancy

As at July 2015, the vacancy rate in the Sydney CBD retail Core has declined to 3.3%, down from 4.1% 18 months earlier. The presence of international retailers seeking prime retail space has been the main catalyst, as it has forced some retailers to look beyond the Super Prime retail Core (see back page for definition). This displacement has meant that some previous vacancies in secondary locations have now been absorbed. For example, Uniqlo's occupancy of all but a café on level 1 at the Mid City Centre has forced 18 retailers to look for alternative premises, while Forever 21 has forced three major retailers to look elsewhere for a new premises.

TABLE 1

Sydney CBD Retail Core

Vacancy by retail type (%)

	Jan-14 (%)	Jul-15 (%)
Arcades/Laneways	4.5	3.2
Street Frontages	3.5	3.5
Shopping Centres	2.9	3.3
Total Retail Vacancy	**4.1**	**3.3**

Source: Knight Frank Research
*For definition of CBD Retail Core, see back page

The largest reduction in the vacancy rate over the past 18 months was recorded in Arcades, falling from 4.5% to 3.2%. Arcades, which in past years have had difficulty in leasing the top floors, are now close to full occupancy. This result has been supported by the expansion of existing tenants, while the growing shortage of available leasing options in the Super Prime retail Core has augured well for other centres and arcades as tenants have been forced to look further afield for suitable options.

While churn has occurred, the vacancy rate for Street Frontage shops has remained on par with the level recorded 18 months ago at 3.5%. However, it is evident that certain precincts have had a greater pull in attracting new tenants. The luxury strip, which primarily runs along Castlereagh Street and houses the likes of Prada, Gucci and Chanel is extremely tight with no vacant space running from Martin Place to the north and Market Street to the south. The precinct's attractiveness for luxury retailers is accentuated by Cartier leasing the previously vacant space at 74 Castlereagh Street. The high end retailer will move from the MLC centre in the coming months and will occupy circa 1,000m² across three levels at the new flagship store.

Similarly, George Street which accommodates a mix of luxury, clothing and personal retailing (including Burberry and Louis Vuitton) has recorded a modest fall in the vacancy rate to 2.0% (down from 2.4%). This reduction was the result of a modest rise in tenant demand, particularly from personal goods retailers (including mobile phones and accessories).

Despite a considerable increase in international retailer demand, Shopping Centres have experienced a small increase in their vacancy rate from 2.9% to 3.3%. The bulk of the available space at centres within the CBD retail Core are small and in inferior locations which do not offer the appropriate size or frontage for retailers seeking flagship stores.

Tenancy Mix & New Supply

The retail tenancy mix in the Sydney CBD retail Core remains dominated by clothing, footwear & soft goods retailers, while the proportion differs somewhat by location and retail type. Overall, clothing, footwear & soft goods retailing represents 36.9% of all retail shops within the CBD retail Core, largely in the form of women's clothing (12.0% of total) and other clothing retailing (10.7% of total) which incorporates unisex retailers like Zara and Topshop/Topman. However, clothing, footwear & soft goods weight is far greater within CBD Shopping Centres at 45.3%. Within other retail formats, the dominance is less pronounced, particularly Street Frontages where clothing, footwear & soft goods retailers represent only 29.4% of shops.

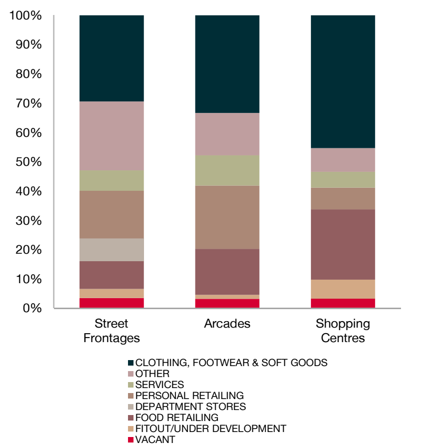
The second most dominant retail type in the CBD retail Core is food retailing (17.4%), closely followed by personal retailing (14.7%), the bulk of which were watch and jewellery retailers.

Over the past 18 months, the growing popularity of food retailing, particularly in specialised food, saw its market share increase from 14.1% to 17.4%. This is in line with the solid turnover growth recorded in takeaway, cafes and restaurant retailing across the state, averaging 16.3% per annum over the past two years; compared to 7.7% for total retail turnover in NSW over the same period.

Currently a number of centres and arcades are undergoing refurbishment in response to a greater focus on the 'experience' side of retailing. At the same time, to accommodate further international retailer expansions into the Sydney CBD, a number of centres have recently completed or are in the process of refurbishment for such retailers. The recent completions include the Sydney Arcade and The Galleries for Forever 21 (June 2015) and MUJI (May 2015) respectively, while the Glasshouse Centre is currently undergoing works to accommodate H&M and Zara Home.

Beyond this, a number of mixed use buildings are undergoing refurbishment/ redevelopment and will contain retail tenancies. This includes 5 Martin Place, 20 Martin Place, 333 George Street and 383 George Street. In addition, a number of properties are currently upgrading their food and beverage offering within their food courts including the MLC Centre, Australia Square/ Governor Place and Gateway.

FIGURE 1
Sydney CBD Prime Core Retail Tenancy Mix
% of number of shops by type



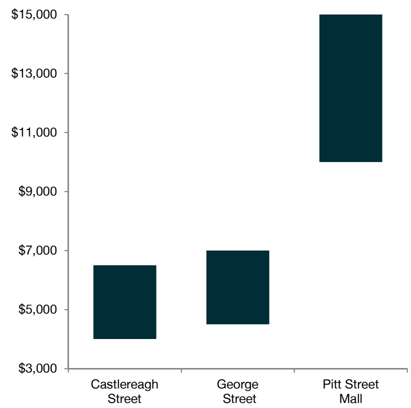
Source: Knight Frank Research

Tenant Demand & Rents

The persistent demand from overseas retailers seeking prime space within the CBD retail Core has continued to underpin leasing activity in the Sydney CBD. While demand is high, a lack of suitable options which offer the scale and appropriate street frontage has curtailed activity to some extent, with a number of international retailers waiting significant periods until suitable options become available. This was the case with H&M which spent four years seeking to enter the Sydney CBD, before securing 5,000m² at the Glasshouse Centre.

Despite the lack of available leasing options, rental rates in the Sydney CBD have remained relatively stable over the past 12 months, while moderate rental growth has occurred in both the CBD retail Core and the Super Prime retail Core. Depending on location and frontage, the rental range and recent growth varies significantly. Gross retail rentals in the Super Prime retail Core which encompasses Pitt Street Mall currently ranges from $10,000/m² to $15,000/m², while a selected number of recent leases have been above $15,000/m². For premises outside the Super Prime retail Core, gross rental rates currently average between $4,000/m² and $7,000/m² (see Figure 2), while secondary retail premises achieve gross rents in the range of $1,000/m² to $3,000/m².

FIGURE 2
Sydney CBD Core Retail Rental Ranges by Type
$ per sq.m—Gross



Source: Knight Frank Research

In recent months, a number of lease deals have occurred which will place further downward pressure on the CBD retail Core vacancy rate over the next 12 months. This includes Microsoft and Sephora at Westfield Sydney, Mimco at the Mid City Centre and undisclosed tenants at 333 and 383 George Street respectively.

Investment Activity

Despite a lack of retail strata space available for sale, transaction volumes in the Sydney CBD have remained steady, with the momentum in the broader retail market flowing through to increased demand for CBD retail strata space. With fewer assets being brought to the market at a time when capital flows are at historical highs, investors are becoming more aggressive in their approach to secure assets. In turn, yields have tightened, with recent strata sales selling in the 4.0% to 5.0% yield range on average.

During CY2014, CBD retail (strata) sales totalled $90.1 million, 16% of which was located along Pitt Street, 11% on Castlereagh Street and a further 9% on Martin Place, underpinned by the sale of 1/53 Martin Place (Lindt Café) for $8 million. Assets priced below $4 million dominated sales volumes, accounting for 58% of the total volumes and 81% of assets exchanged. Asian investors have been the most active players in the market, with 80% of analysed Sydney CBD retail (strata) transactions for CY2014 stemming from Hong Kong investors.

While only a limited number of retail strata investments have exchanged during 2015, a number of large sales have occurred which has pushed sales volumes to $66.1 million for the first half of 2015. The most notable being the former Darrell Lea retail shop (now tenanted by Telstra) at 396 George Street for circa $26.2 million.

TABLE 2
Recent Sales Activity Sydney CBD Retail

Address	Price ($m)	Initial Yield (%)	GLAR (m^2)	$/$m^2$ GLAR	Sale Date
Shop 2, 57 York St	$2.97	3.90	78	$38,115	Jul-15
Shop 1, 57 York St	$2.34	4.05	59	$39,661	Jul-15
Shop 181, 569 George St	$5.64	4.32	85	$64,500	May-15
Shop 2, 70 Pitt St	$2.16	6.34	19	$113,684	Apr-15
234 George St (Pie Face)	$4.03	5.10	55	$73,182	Apr-15

TABLE 3
Recent Leasing Activity Sydney CBD Retail

Address	Tenant	Gross Rent $/$m^2$	GLAR	Term	Lease Date
Mid City Centre	Mimco	15,000*	85	6	Jun-15
99 Pitt St	Westpac	3,750*	2,700	7+5+5	Jun-15
254 George St	Bankwest	3,000*	232	10+10	Feb-15
147 King St	Franck Muller	4,000*	75	5+5	Feb-15
Westfield Sydney	Sephora	N/A	560	N/A	Dec-14

Source: Knight Frank Research *Approx.

Outlook

Looking ahead, demand for retail space within the Sydney CBD retail Core is expected to strengthen over the next 12 months, stemming from the continued displacement of retailers in and around the Super Prime retail Core. However, unlike previous years where the displacement was underpinned by 'fast fashion' retailers seeking large prime space, the next two to three years will be supported by new and existing luxury retailers looking for 'flagship sites', including Kering, Richemont and LVMH Group amongst others.

With the bulk of recent refurbishments and new developments being pre-leased (e.g. H&M and Zara Home at the Glasshouse Centre), any further demand from both local and international retailers will place upward pressure on rental rates, particularly until forthcoming supply along George Street in conjunction with completion of the light rail project. In this case, the current gap between Pitt Street Mall and George Street rents are likely to narrow, with several large apartment projects boosting the local population and foot traffic along George Street, and hence demand for retail space.

Retail Core Definitions:
Knight Frank's survey covers the key CBD retail precinct as defined as the Core. The CBD retail Core includes all retail premises within the broad boundaries of Martin Place to the North, Park Street to the South, Castlereagh Street to the East and George Street to the West. The Super Prime retail Core, home to the recent influx of international retailers encompasses the Pitt Street Mall.

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RESEARCH
Luke Crawford
Senior Analyst
+61 2 9036 6629
Luke.Crawford@au.knightfrank.com

Bradley Rehn
Assistant Analyst
+61 2 9036 6656
Bradley.Rehn@au.knightfrank.com

Matt Whitby
Group Director
Head of Research and Consultancy
+61 2 9036 6616
Matt.Whitby@au.knightfrank.com

NSW
Richard Horne
Managing Director, NSW
+61 2 9036 6622
Richard.Horne@au.knightfrank.com

VALUATIONS
Matthew Russell
National Director
+61 2 9036 6619
Matthew.Russell@au.knightfrank.com

RETAIL LEASING
Alex Alamsyah
Senior Director - Retail Leasing
+61 2 9036 6693
Alex.Alamsyah@au.knightfrank.com

Michael Hanscomb
Director - Retail Leasing
+61 2 9036 6739
Michael.Hanscomb@au.knightfrank.com

RETAIL SALES
Ben Stewart
Director - Sales
+61 2 9036 6625
Ben.Stewart@au.knightfrank.com

Andrew Palmer
Senior Sales Executive
+61 2 9036 6646
Andrew.Palmer@au.knightfrank.com

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