Australia Property Insights

Central Sydney Planning Strategy: Commercial property impact

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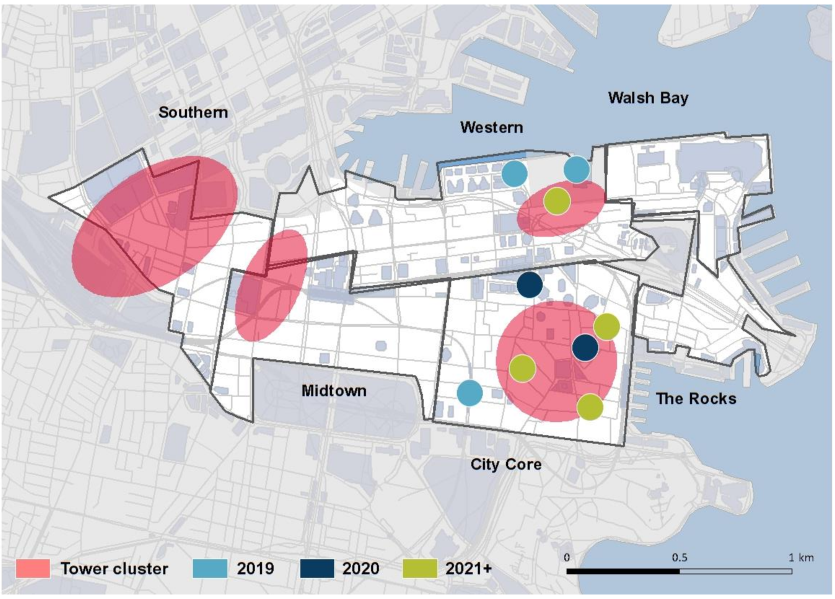
The City of Sydney recently released a draft Central Sydney Planning Strategy (CSPS). This report reviews some of the key proposals and their potential impact on commercial property. Key points include:

- The CSPS aims to reduce the proportion of residential development and nearly triple the amount of floor space that can be added before capacity is reached.
- This should provide for jobs growth of around 100,000 over the next 20 years and help continue the Sydney CBD's role as a key driver of economic growth.
- All new towers over 55m would have to be at least 50% commercial space and require a site size of at least 1,000 sq m.
- Developers could build up to 300m, depending on location (up from 235m), if the towers are 100% commercial use, i.e. a 28% increase in height.
- The new towers should be centred in four main clusters in the core, western, midtown and southern precincts (Figure 1).
- Ongoing economic growth should help drive property valuations, with the sites best able to leverage the additional height gaining the most uplift. This is likely to lead to higher statutory valuations with a flow on to certain rates and land taxes.
- Whilst the current supply pipeline suggests the office rental market will favour landlords for the next four to five years, the potential uplift to development size combined with a period of above average rental growth over the next few years could result in a relatively large wave of new office supply after 2021 and downward pressure on rental growth.

Figure 1

Proposed CBD tower clusters and developments by expected completion year



Source: CSPS; Cushman & Wakefield Research

The Central Sydney Planning Strategy

A draft Central Sydney Planning Strategy (CSPS), was released on Wednesday 13 July. The Strategy is a 20-year growth plan that revises previous planning controls and aims to produce a green, global, connected city. Key points of the CSPS include:

- All new towers over 55m would have to be at least 50% commercial space.
- Developers could build up to 300m, depending on location (up from 235m), if the towers are 100% commercial use, i.e. a 28% increase in height.
- The potential size of towers in the western edge increases from 80 to 110m, a 38% increase in height.
- Building height will be limited to 55m or less on sites with an area of 1,000 sq m or less, or on sites that cannot meet performance criteria.
- The new towers should be centred in four main clusters in the core, western, midtown and southern precincts.
- The changes should unlock 2.9 million sq m of floor space. Without change, projected additional capacity will be limited to 1 million sq m.
- The additional floor space should provide for over 100,000 jobs at 20 sq m per job (all sectors). This would be limited to 50,000 jobs without the change.
- The change should deliver 300-520 new affordable housing units. To help fund this, an affordable housing levy on developments will be phased in.
- CBD employment is projected to grow from 286,000 in 2012 to 375,000 by 2036 or 1.2% per annum.
- CBD residents are projected to grow from 25,000 in 2012 to 44,000 by 2036, a growth rate of 3.0% per annum.
- Within the CBD area, commercial property will be prioritised (over residential) for its ability to support future jobs growth. The additional potential supply should help Sydney to remain competitive globally.

Economic growth

The CSPS notes that central Sydney generates more than $68 billion gross output per annum, or nearly 5% of total Australian GDP, and is home to Australia's highest value workers ($104 per hour per worker in 2012). This suggests central Sydney is a key driver of Australian economic growth. Additionally, office space accommodates four out of five Australian workers, so ensuring adequate provision of employment accommodation is key to future growth.

The additional potential employment floor space available for development should help ensure the Sydney CBD continues to be a key driver of Australian employment and economic growth.

New supply

As noted above, the CSPS proposals should nearly treble the CBD's future floor space potential.

While new floor space is likely to be a mix of office, retail, hotel and residential, the requirement that to achieve maximum heights the space must be 100% commercial suggests much of the new space will be office. If so, Sydney CBD's total office stock could increase by more than 50%, from the current level of approximately 5 million sq m, before reaching capacity.

Employment potential

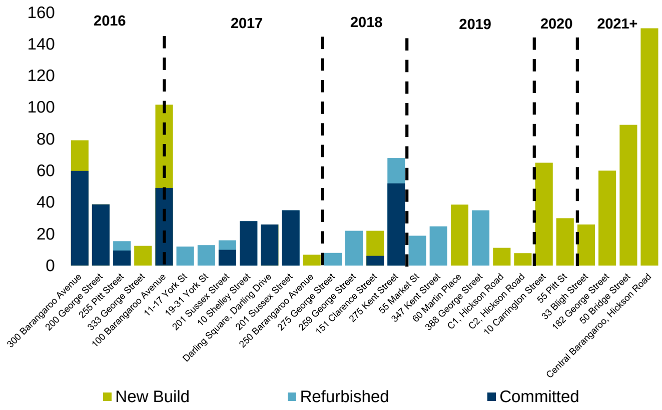
The CSPS suggests that after implementing the proposed changes, the additional potential floor space will provide space for 100,000 jobs. Without the change, it is suggested employment growth will be limited to 50,000.

The Strategy assumes a floor space ratio (FSR) of 20 sq m per job. This is across all sectors. However, the FSR in the office sector is currently less than half the CSPS assumption at around 8 to 10 sq m per person.

If the bulk of the potential floor space is office, the CSPS may have underestimated the employment and economic growth potential of the increased capacity.

Figure 2

Sydney CBD supply by building, ('000 sq m)



Source: Cushman & Wakefield Research

Supply pipeline

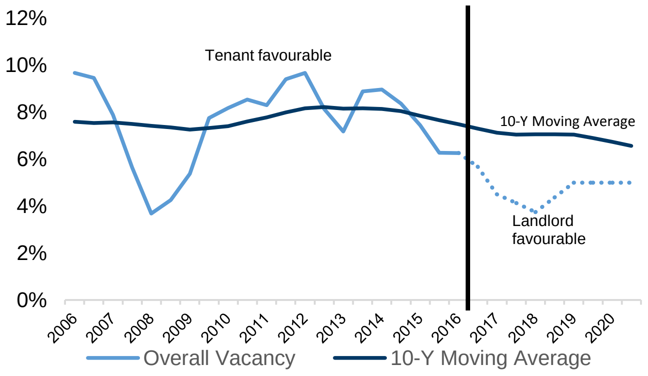
The Sydney CBD office market has a limited pipeline of new stock over the next five years. Most proposed developments are unlikely to complete before 2021 (Figure 2). The problem will be compounded due to the withdrawal of a significant amount of office space to make way for Sydney metro stations and residential or hotel conversion. This period of flat or negative net supply may be extended if some development proposals are delayed for increased height options to be explored.

If demand holds up, the limited supply should push vacancy below the long term average for the next four to five years (Figure 3) and generate relatively strong rental growth.

Any delay to additional supply could extend the 'landlord favourable' conditions in the CBD. However, it may also contribute to a larger wave of new stock arriving after 2021. This could be driven by larger developments as well as the potentially longer period of strong rental growth. Depending on demand conditions at the time, this could result in flat or negative rental growth.

Figure 3

Sydney CBD vacancy rate (%)



Source: PCA; Cushman & Wakefield Research

Retail and hotel supply

As well as office space, the proposed changes, e.g. a 50% cap on the proportion of floor space that can be used for residential accommodation in new developments, should also encourage development of retail and hotel space.

A key driver of retail turnover growth is population growth. With employment growth projected at 1.2% pa and residential population growth at 3.0% pa, this should provide a solid base for retail sales growth as well as encouraging the diversification of the retail mix below office towers.

A key trend in recent years has been the increase in supermarket and grocery retail in the CBD, ongoing employment and residential growth should continue to support this trend.

Demand for hotel space will also increase and the CSPS proposals should allow for ongoing development in this sector. The Strategy noted visitor accommodation demand is forecast to increase by over 60% between 2012 and 2022/23. Interestingly, while the number of leisure travellers is significantly more than corporate travellers (60% vs 30% of all travellers), corporate travellers occupied a similar number of rooms. The potential growth in the office sector would therefore require a proportionate increase in accommodation for corporate travellers.

Valuation

The proposed increase in the maximum height of 100% commercial buildings from 235m to 300m (+28%) in some locations, and 80m to 110m (38%) in the western edge, has the potential to generate increases in value for Sydney CBD office buildings.

Sites best able to leverage the increases should get the most uplift, but nearby sites would also benefit from the gains as well as from the ongoing economic growth.

The extent of the valuation uplift would vary on a case by case basis but some factors to consider include:

- Location: Only a limited number of locations in the CBD will be able to take full advantage of the proposed height increase.
- Site size: To allow for appropriate setbacks and separation, the minimum tower site size would be increased to 1,000 sq m, providing public amenity and outlook requirements are met. This should further limit the number of sites able to take advantage of the increase.
- Construction cost: Construction cost increases with height, increasing the economic rent required for taller buildings.
- Rent: The upper floors in the taller towers are likely to achieve premium rents, depending on the outlook.
- Heritage restrictions: Heritage restrictions on some sites will limit their potential to take advantage of the new height limits.
- Strata: Strata office valuations may enjoy an uplift if a developer seeks to consolidate ownership.
- Sustainability: New office buildings will be required to achieve at least a 5 star NABERS rating. Performance data from Investment Property Databank (IPD) indicates higher NABERS rated buildings tend to outperform in capital growth and achieve higher rents.
- Affordable housing contribution: All new developments will be required to make a monetary contribution toward affordable housing. For non-residential developments, this is reported to be equivalent to 1% of floor space from 1 June 2020 and 3% for residential developments.
- Statutory valuations: Sydney CBD land values used to determine payments such as rates and land tax are based on potential FSRs rather than existing. Depending on the location, the increase in potential FSR should also result in an increase in some of these costs.

Overall, the proposed increase in floor space and the associated uplift in employment and economic growth should be positive for valuations over the long term.

Conclusion

The proposed changes outlined in the CSPS provide for the long-term growth of the Sydney CBD with estimates that the additional floor space could increase office stock by over 50% and provide for around 100,00 additional jobs.

This should help ensure the Sydney CBD remains a key driver of Australia’s economic growth. The ongoing growth adding to property valuations, with sites best able to leverage the additional heights achieving the best uplift.

Whilst the current supply pipeline suggests the market will favour landlords for the next four to five years, the potential uplift to development size combined with a period of above average rental growth over the next few years could result in a relatively large wave of new office supply and downward pressure on rental growth after 2021.

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