- *Activity has been significantly impacted by Covid-19*
- *Face rents are holding but incentives have increased*
- *Investment volumes were down in H1, but new activity is emerging*

Knight Frank

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North Shore Office

Market Report, October 2020

COVID CREATES HEADWINDS, BUT BUSINESS ADAPTING

8.0% VACANCY
North Sydney PCA July2020

60%
of all leases in North Sydney were to Tech occupiers

$414 MILLION TURNOVER
H1 2020

"...the diverse leasing profile of all the North Shore markets and ongoing infrastructure upgrades to improve connectivity with the CBD as part of the Three Cities plan is helping to sustain confidence levels."

The Key Insights

Amidst economic uncertainty due to the Covid-19 pandemic and government restrictions on movement, office leasing activity has declined and vacancy rates have started to rise.

Constrained activity due to Covid-19 has prompted a rise in incentives in all North Shore precincts to within a 25-30% range, putting downward pressure on effective rents through the first half of 2020.

Total investment volumes for the North Shore markets in H1 2020 reached $414 million, down from $1.03 billion in H1 2019.

Pricing on North Shore prime assets during H1 indicates that yields have held firm as Covid-19 has constrained investment activity.

Delayed decision making has impacted North Shore investment volumes in H1 2020 but rebound is possible with several institutions looking to trade.

North Shore Office Market Indicators—July 2020

MARKET	GRADE	TOTAL STOCK SQM	VACANCY RATE %	SIX MONTH NET ABSORPTION SQM	SIX MONTH NET ADDITIONS SQM	AVERAGE GROSS FACE RENT $/SQM	AVERAGE INCENTIVE %^	AVERAGE CORE MARKET YIELD %*
North Sydney	Prime	266,510	5.6	8,411	0	972	25-30	4.50-5.00
North Sydney	Secondary	558,257	9.2	-7,786	4,230	832	25-30	5.00–5.50
North Sydney	**Total**	**824,767**	**8.0**	**625**	**4,230**			
St Leonards	Prime	80,912	1.1	0	0	764	25-30	5.00-5.50
St Leonards	Secondary	223,135	11.8	-9,976	-4,230	663	25-30	5.75-6.25
St Leonards	**Total**	**304,047**	**9.0**	**-9,976**	**-4,230**			
Chatswood	Prime	132,181	9.0	-9,087	0	711	25-30	5.25-6.00
Chatswood	Secondary	141,843	8.6	-4,843	0	611	25-30	5.50-6.00
Chatswood	**Total**	**274,024**	**8.8**	**-13,930**	**0**			
Macquarie Park	Prime	616,726	6.3	15,268	35,000	520	25-30‡	5.50-6.00
Macquarie Park	Secondary	277,308	8.0	-1,699	0	458	27-33‡	6.00-6.50
Macquarie Park	**Total**	**894,034**	**6.8**	**13,569**	**35,000**			

Source: Knight Frank Research/PCA *assuming WALE 5.0 years ^Incentives are on a Gross basis ‡Incentives are on a net basis

NORTH SYDNEY

Subdued tenant activity limits overall absorption, whilst appetite holds for premium

Tenant demand over the last six months has been restrained. Government enforced restrictions to contain Covid-19 resulted in businesses implementing remote working policies and an underutilisation of office space. Reflective of this is the limited absorption levels in the six months to July 2020 totalling 625sqm.

Despite overall leasing volumes being down, the trend of technology and media occupiers in North Sydney continues, accounting for 60% of leasing volumes this year. New entrants include Cloud software operator Okta and WorkForce Software.

Premium grade office space scarce

The flight to quality trend coupled with the crystallisation of lease deals in 100 Mount Street has resulted in no vacancy in the premium grade market as at July 2020. This has been offset by a rise in secondary vacancy from 7.1% to 9.2% in the six months to July 2020. A rise in sub lease vacancy and negative absorption has also contributed to this. Total vacancy in North Sydney has had a slight uptick from 7.6% to 8.0% in the six months to July 2020.

New developments substantially pre-let

North Sydney's largest office development by Winten Property Group, 1 Denison Street (60,338sqm) has recently completed. The development is now over 80% committed, including anchor tenants Nine Entertainment (27,000sqm), Microsoft (10.6000sqm) and SAP (5,700sqm).

Furthermore 118 Mount Street (20,770sqm), 65% committed to Zurich financial services, is due for completion by year end.

The Victoria Cross OSD was recently announced on the NSW Government list of state significant projects to be fast tracked, in order to boost the economy and generate jobs. Developed by Lendlease, the project will boast over 55,000sqm of premium office space, with completion in 2024. With projects currently under construction substantially committed, the future pipeline bodes well for North Sydney given the limited premium space available and the likelihood that the current market conditions would have improved upon completion of these developments.

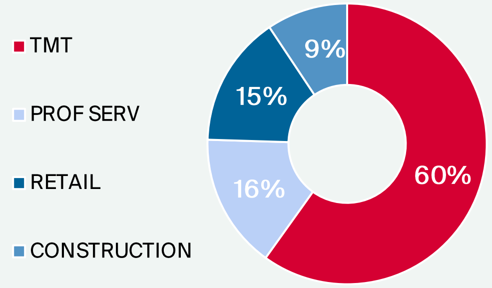
Rental growth halts and incentives rise

The strong rental growth experienced over the last couple of years has halted as a result of market uncertainty due to Covid-19 and the decline in tenant activity over the last six months. As a result, average prime gross rents have remained unchanged since January 2020, measuring $972/sqm ($829/sqm net face). Similarly in the secondary market gross rents are unchanged at $832/sqm ($694/sqm net face) as at July 2020. On a gross basis prime rents are running at a 30% discount to the CBD, above the 10 year average of 26%, offering tenants relative value compared to the Sydney CBD.

As the tenant demand pool remains limited, landlords have increased incentives in order to retain and attract tenants. Prime incentives have risen to average 26.3% as at July 2020, up from 21.3% in January. This has led to net effective rents dropping by 7.3%YoY to measure $574/sqm. Secondary incentives have climbed to 25.5%, resulting in a drop of 7% of net effective rents to record $482/sqm.

Lease Deals by Industry Sector

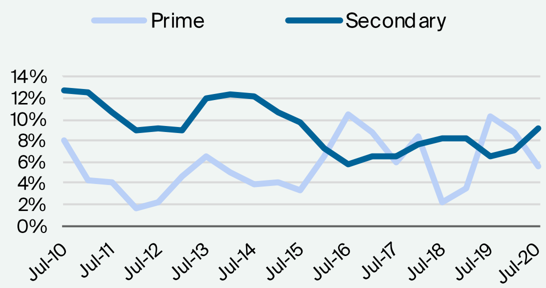
North Sydney, 2020 (to August), Total market (sqm)



Source: Knight Frank Research TMT= Technology, Media, Telecoms

North Sydney Vacancy

% By Grade



Source: Knight Frank Research

ST LEONARDS

Limited tenant activity

As experienced across all markets, tenant activity has been limited over the last six months due to Covid-19. Tenants have put decisions around office space on hold throughout the period. This has resulted in negative absorption levels, directly attributed from the secondary market, which saw absorption decline by 9,976sqm in the six months to July 2020. In the prime market there was no movement in absorption levels given the tightly held nature of the stock.

Prime space remains tightly held

Despite the lack of tenant activity across the wider market, prime grade space in St Leonards remains scarce with the prime vacancy rate measuring 1.1% as at July 2020, its lowest level on record. Reflective of the tightly held nature is Verizon's renewal of c3,500sqm at 203 Pacific Highway for a further five years.

Due to a decline in absorption levels in the secondary market, the secondary vacancy rate increased from 9.1% to 11.8% in the six months to July 2020. This is likely to rise further due to the impending backfill space from NSW Health at 100 Christie Street (c10,000sqm) into its new headquarters at the Royal North Shore Hospital Campus due for completion at the end of the year.

Health care precinct developments near completion

The NSW Government led development at the Royal North Shore Hospital Southern Campus is now complete. The new development of c27,000sqm of prime office space is 100% committed to the Department of Health, which will see them consolidate from Zenith Towers in Chatswood and 100 Christie Street into one location. Furthermore, The North Shore Health Hub at 7 Westbourne Street, being developed by Dexus, is on track for completion in early 2021. The project will encompass c15,750sqm of medical/consulting space across two buildings, of which over 75% has already been committed, including space leased to Ramsay Health Care and Genesis Care.

The developments will likely be beneficial for tenant activity in St Leonards, especially from private health sector tenants as they may look to expand within or relocate into St Leonards to be in closer proximity to the North Shore Health Care Precinct.

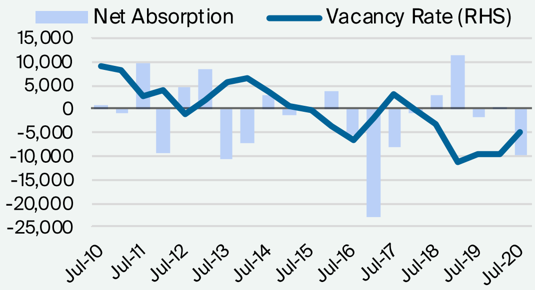
Rents halt and incentives rise

The above trend rental growth experienced in St Leonards over the last few years has halted amidst the market uncertainty and limited tenant demand due to Covid-19. On a 12 month basis (to July 2020), average prime gross face rents have increased by 3.6% to $764/sqm ($634/sqm net face), however they are unchanged since January. Secondary rents rose by 1.5% in the 12 months to July 2020 to $663/sqm ($558/sqm net face), but also remaining unchanged since January.

Similar to competing markets, incentives have risen as owners seek to attract and retain tenants. Average prime incentives have increased to 26.5%, decreasing net effective rents to $432/sqm, down 4.7% in the six months to July 2020. Average secondary incentives have risen to 27%, declining net effective rents by 7% to $379/sqm.

St Leonards Vacancy & Net Absorption

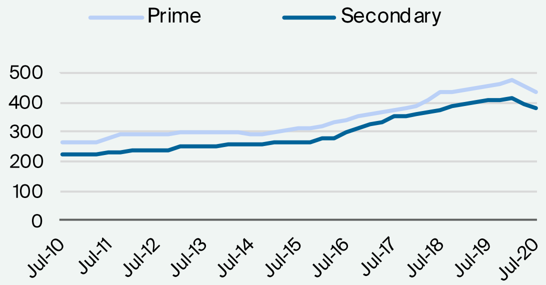
Sqm,% (12 months to July 2020)



Source: Knight Frank Research, PCA

St Leonards Net Effective rent

Average Rent $/sqm, By Grade



Source: Knight Frank Research

CHATSWOOD

Vacancy rises in the first half of 2020 as a direct result of Covid-19

Chatswood office market has been impacted by a decline in tenant demand, as occupiers review office requirements brought on by Covid-19. As a result, Chatswood's vacancy rate has more than doubled since the pandemic started.

Several direct whole floors have come back to the market and sublease vacancy has also increased. After reaching a 20-year low of 3.7% in January 2020, total vacancy in Chatswood rose to 8.8% in July 2020. All grades recorded an increase in vacancy over the period, with total net absorption declining by 13,930sqm in the six months to July 2020

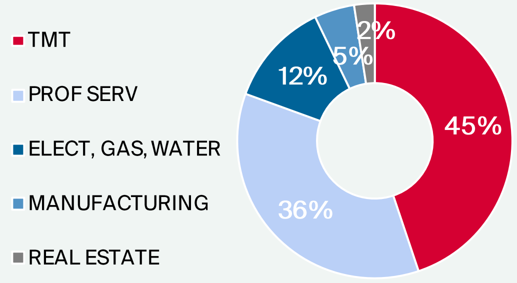
Deals done in the first quarter did reflect strong take-up by the tech sector through the renewal of leases. However, given venture capital funding has declined during the pandemic, the potential for new tech to scale in the short-term has been curtailed.

Deals on hold through the pandemic but early signs emerge that tenants are resurfacing to review A Grade options

There has been limited new deal activity since March, with occupiers tending to put decisions to relocate or expand on hold. There are early signs of tenants reviewing options due to the increase in availability levels of A grade space following previously tight conditions. Although, it is noted that some of these size requirements have been reduced since Covid-19.

Lease Deals by Industry Sector

Chatswood, 2020 (to August), Total market (sqm)



Source: Knight Frank Research TMT= Technology, Media, Telecoms

Rental growth on hold as incentives lift due to Covid-19

After several years of strong rental growth, uncertainty surrounding short-term leasing decisions during the pandemic has halted any further face rental growth and seen incentives rise during the first half of 2020.

On a 12 month basis (to July 2020), average prime gross face rents have increased by 1.2% to $711/sqm ($789/sqm net face), however they are unchanged since January 2020 . Secondary rents rose by 1.4% in the 12 months to July 2020 to $611/sqm ($497/sqm net face), but are unchanged since January.

Average prime incentives have increased to 28%, decreasing net effective rents to $379/sqm, down 10.3% in the six months to July 2020. Average secondary incentives have risen to 28.7%, declining net effective rents by 10.1% to $322/sqm.

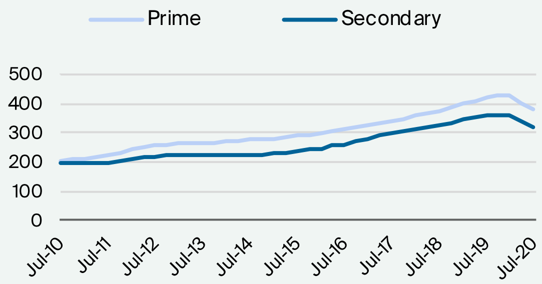
Investor JV increases expansion plans for tower

In early 2020, Cromwell sold a 50% stake in 475 Victoria Avenue for $120 million and entered into a joint venture for its expansion with a private fund managed by BlackRock . An amended development application was recently submitted for an 11-level 6,500sqm commercial tower to sit between the twin 14-storey existing towers, which comprises c22,000sqm. The amended plan replaces the previously approved five-floor addition of c3,140sqm.

The new metro line has helped to bolster Chatswood's transport connectivity profile, which in the midst of a workplace reset bodes well for long-term capital appreciation.

Chatswood Net Effective Rents

Average Rent $/sqm, By Grade



Source: Knight Frank Research

MACQUARIE PARK

Rise in office vacancy rates due to completion of new supply

While overall leasing activity across the North Shore has been impacted by Covid-19, vacancy in Macquarie Park has increased due to completion of the 34,270sqm Glasshouse building in April. The building forms part of John Holland's Macquarie Square development and is anchored by a substantial pre-commitment from the NSW Government, however was not fully let on practical completion contributing to the rise in vacancy rate in July 2020 to 6.8%, up from 4.6% in January.

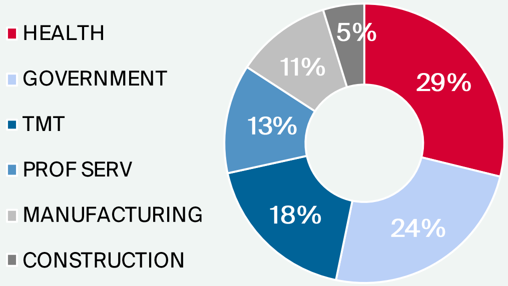
Leasing demand from high tech health/pharma and government occupiers remains positive

There have been several new lease transactions since March reflecting the demand for new prime space in the precinct, particularly from high tech health/pharma, government and tech occupiers. Health Care and Social tenants accounted for 29% of leasing take-up in H1, well above its five-year average of 10%. Government entities accounted for 24%, just slightly ahead of its five year average of 22% and the tech sector accounted for 18%, similar to its five year average of 17%

The shift in demand from the health care sector, including pharma, reflects the upcoming availability of prime grade space which has been in short-supply in Macquarie Park for some time. Prior to the Glasshouse completion in April, no new significant buildings have been added to Macquarie Park for five years and with prime vacancy dropping to a historic low of 3.3% in January 2020, demand from pharma, tech, electronic and manufacturing related companies has been building.

Lease Deals by Industry Sector

Macquarie Park, 2020 (to August), Total market (sqm)



Source: Knight Frank Research TMT= Technology, Media, Telecoms

Leasing demand provides investors confidence as large assets trade

Goodman Group's new development, Macquarie Corporate Centre on Banfield Road, is due for completion in Q3. The 14,675sqm building is anchored by c6,900sqm commitment from Schneider Electric, who is relocating from nearby. Biogen Australia and Endotherapeutics have also recently secured terms. AEW Capital Management, a US real estate investment manager, recently acquired the centre for $144.5 million from Goodman. The sale on a reported core market yield of 5.1% suggests that there is confidence in the strength of tenant demand for office space in Macquarie Park.

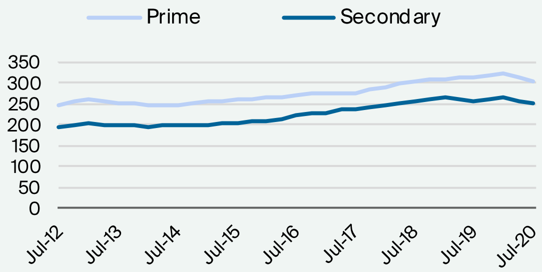
In March, Charter Hall's Direct PFA Fund and Long WALE REIT in an equal partnership (50:50) acquired the Glasshouse building from John Holland for $331.3 million. More recently, Keppel REIT announced that it had acquired the three office buildings known as Pinnacle Office Park from Goodman Group for $306 million.

Face rents unchanged since the pandemic began but incentives are rising, putting downward pressure on effective rents

On a 12 month basis (to July 2020), average prime gross face rents have increased by 3% to $520/sqm ($415/sqm net face), however are unchanged since January. Secondary rents rose by 5.2% in the 12 months to July 2020 to $458/sqm ($353/sqm net face) but are unchanged since Covid-19 pandemic started. Average prime incentives have increased to 27% and resulted in net effective rents falling to $303/sqm, down 6.4% in the six months to July 2020. Average secondary incentives have risen to 29%, declining net effective rents by 6.6% to $250/sqm.

Macquarie Park Net Effective Rents

Average Rent $/sqm by grade



Source: Knight Frank Research

NORTH SHORE INVESTMENT

Delayed decision making has impacted investment volumes in H1 but rebound is possible with several institutions looking to trade

The economic uncertainty due to Covid-19 and subsequent government-imposed restrictions on movement has impacted occupier demand and delayed short-term investment decision making.

Total investment volumes for the North Shore markets in H1 2020 reached $414.0 million, down from $1.03 billion in H1 2019.

Although Covid-19 has constrained activity, the North Shore office market has traditionally been tightly held with investors typically holding assets with a long-term view.

The low volume of deals and supply of assets for sale during the first half of 2020 also suggests that the short-term easing of leasing demand may have been producing some headwinds to overall investment activity.

However, the relatively diverse leasing profile of the North Shore markets may provide some confidence to investors looking to enter this segment of the market.

Prime yields hold firm during the first half of 2020

While there has been a lower volume of sales, pricing on prime assets that traded in the first half of the year indicate that yields have held firm. North Sydney average prime yields remain at 4.8%, St Leonards at 5.25%, Chatswood at 5.8%, and Macquarie Park at 5.75%.

Rebound in investment volumes on the cards for H2 2020

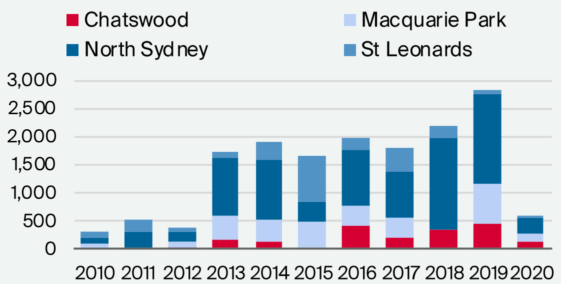
While there's been a hiatus on activity since March, there are signs that investors are weighing up opportunities following two significant transactions recently.

It is understood that Goodman Group sold its almost completed Macquarie Corporate Centre to AEW Capital Management for $144.5 million in September on a yield of 5.1%.

More recently, Goodman Group has exchanged contracts to sell Pinnacle Office Park in Macquarie Park to Keppel REIT for $306 million on a yield of c5.2%.

With several institutional owners looking to trade prime assets in the coming months, a rebound in investment volumes is likely in the second half of the year.

North Shore Office Sales $10m+
By Precinct ($m), 2020 to August



Source: Knight Frank Research

Recent significant sales

PROPERTY	PRICE $M	CORE MARKET YIELD %	NLA SQM	$/SQM NLA	WALE	PURCHASER	VENDOR	SALE DATE
1 Giffnock Ave, Macq Park~	167.2	6.1*	19,384	8,628	3.0	Ascendas REIT	Frasers,Winten	Sep-20
4 Drake Ave, Macq Park	306	5.2*	41,595	7,356	4.8	Keppel Capital	Goodman Group	Sep20
60 Pacific Hwy, St Leonards	33.8	5.30	2,921	11,571	3.0	EG Funds Management	Private managed by AMP Capital	Aug-20
2 Banfield Road, Macquarie Park	144.5	5.10	14,675	9,867	7.3	AEW	Goodman Group	Aug-20
Central Plaza, Chatswood (50%)	120.0	5.40*	24,812	9,673	2.8**	BlackRock	Cromwell Property Group	Feb-20
100 Walker St, North Sydney	166.5^	5.00*	10,788	15,434	6.0**	Pro-Invest	Christies Spaces	Feb-20

*Initial Yield **Approximate WALE ^Leaseback ~Fun d through deal

North Shore major office supply

Address	Region	Area (sqm)	Developer	Major Tenants	Commitment level (%)	Stage	Est. Date of Compl
1 Denison Street	North Sydney	60,338	Winten Property	Nine, Microsoft, SAP	80%	Complete	H2 2020
118 Mount Street	North Sydney	20,770	Zurich	Zurich	65%	U/C	H2 2020
73 Miller Street*	North Sydney	19,000	ESR	oOh!media	40%	U/C	H2 2020
88 Walker Street	North Sydney	13,000	Billbergia	-	-	U/C	2022
2 Blue Street	North Sydney	13,500	Thirdi Group	-	-	DA Approved	2023
173 Pacific Highway	North Sydney	11,000	Maville Group	-	-	DA Applied	2024
Victoria Cross OSD	North Sydney	55,000	Lendlease	Pending Pre-comm	-	DA Approved	2024
RNS Hospital Southern Campus	St Leonards	25,000	NSW Govt	NSW Health	100%	Complete	H2 2020
7 Westbourne Street	St Leonards	15,000	Dexus	Multiple	75%	U/C	H1 2021
The Glasshouse	Macq Park	34,500	Charter Hall	Transport NSW	75%	Complete	H1 2020
Macquarie Corporate Centre	Macq Park	14,700	Goodman	Schneider	75%	U/C	H2 2020
1 Giffnock Avenue	Macq Park	19,400	Ascendas REIT	-	-	DA Approved	2022
45-61 Waterloo Road–Stage 2	Macq Park	70,000	John Holland	Pending Pre-comm	-	DA Approved	2023+
475 Victoria Avenue	Chatswood	6,500	Blackrock/ Cromwell	Pending Pre-comm	-	DA Approved	2023+

* Refurbishment

Recent significant tenant commitments

OCCUPIER	PROPERTY	PRECINCT	SIZE SQM	FACE RENT $/ SQM (n)	INCENTIVE	TERM YRS	START DATE
Gartner Rose	15 Blue Street	North Sydney	600	835	29%	5	Jan-21
Okta~	80 Pacific Highway	North Sydney	1,790	885	28%	5	Feb-21
Access CN~	100 Miller Street	North Sydney	994	830	24%	5	Dec-20
Confluence Water~	475 Victoria Street	Chatswood	1,848	560	26%	5	May-21
Endotherapeutics	Macq Corp Centre	Macq park	798	465	27%	5	Sep-20
PNSW Education~	22 Giffnock Ave	Macq Park	2,900	440	23%	5	Jun-20

Pre-commitment ^ Renewal ~Existing space *Sublease

We like questions, if you've got one about our research, or would like some property advice, we would love to hear from you.

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