- *Improved leasing market conditions*
- *Increase in face rents with incentives holding*
- *Yields begin to soften across all markets*

Knight Frank

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North Shore Office

Market Report, September 2022

POSITIVE MARKET SENTIMENT

90% of investment volumes from offshore capital 2022YTD

25% Of deal activity from tech sector since 2021

$746 million in transaction volumes 2022YTD

"Returning rental growth across North Shore markets for first time in two years"

The Key Insights

Solid tenant enquiry with deal flow activity to pickup throughout the remainder of the year.

With no new significant supply anticipated for North Sydney until at least 2024 the market is well placed to absorb the current availability of stock and drive vacancy down.

Strong buyer appetite from both domestic and offshore groups for core assets in the North Shore, particularly for North Sydney and Macquarie Park, which have accounted for the bulk of transaction activity recently.

Yields are softening across all North Shore markets for the first time since 2009

North Shore Office Market Indicators—July 2022

MARKET	GRADE	TOTAL STOCK SQM	VACANCY RATE %	SIX MONTH NET ABSORPTION SQM	SIX MONTH NET ADDITIONS SQM	AVERAGE NET FACE RENT $/SQM	INCENTIVE %^	CORE MARKET YIELD %*
North Sydney	Prime	364,536	14.9	-67	0	867	30-35	4.75-5.25
North Sydney	Secondary	558,257	22.1	-25,091	0	731	30-35	5.25–5.75
North Sydney	**Total**	**922,793**	**19.3**	**-25,158**	**0**			
St Leonards	Prime	118,585	12.5	3,218	0	646	30-35	5.00-5.50
St Leonards	Secondary	223,301	21.9	-10,231	0	568	30-35	5.75-6.25
St Leonards	**Total**	**340,886**	**18.6**	**-7,013**	**0**			
Chatswood	Prime	132,181	19.8	-,1997	0	592	30-35	5.75-6.25
Chatswood	Secondary	141,273	18.2	-6,280	0	503	30-35	5.75-6.50
Chatswood	**Total**	**273,454**	**15.9**	**-2,281**	**0**			
Macquarie Park	Prime	631,00	9.2	-6,859	-600	430	30-35‡	5.25-6.00
Macquarie Park	Secondary	277,869	13.2	342	0	363	30-35‡	6.00-6.50
Macquarie Park	**Total**	**908,869**	**10.4**	**-6,517**	**-600**			

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

NORTH SYDNEY

Positive occupier demand for top end assets

With the significant influx of new supply over the last two years and large tenant relocations the overall vacancy rate has increased to 19.3% as at July-22. The rise captured in the PCA figures is largely attributed to the negative absorption levels in the secondary market stemming from 105 Miller Street sitting vacant. MLC vacated 28,500sqm as a consolidation to the Sydney CBD and Parramatta. Whilst this asset is reflected in the vacancy figures this space is not available for lease and thus skews the real vacancy figure.

The premium market remains resilient, with premium grade vacancy much lower at 12.8% as at July-22. NBN had initially placed 7,000sqm of space for sublease at 100 Mount Street earlier in the year; however this space has since been leased according to market sources. 1 Denison is over 95% leased and 118 Mount Street is now over 80% committed, emphasising the demand and flight to quality trend for top end assets.

Lease deal volumes since 2021 continue to be driven by the tech sector and professional services accounting for 25% and 26% of take up respectively. There has been strong tenant enquiry and deal flow activity is expected to pick up with a number of deals at final stages of being signed according to market sources. Additionally, market evidence highlights occupiers seeking spaces generally in the sub 1,000sqm bracket with over 65% of deals being done in this range.

Market well placed to absorb current stock levels

There have been no new supply additions or withdrawals in North Sydney since the end of 2020. North Sydney is the second largest metropolitan office market in NSW; with a stock base totalling 922,793sqm of which prime grade stock accounts for 40% of the market, up from 27% five years ago.

Only two boutique developments are under construction; including 88 Walker Street, which will encompass 13,000sqm of commercial space across a mixed use development, due for completion in H1 2023. Additionally, Lendlease is developing a c14,000sqm prime grade office building; known as "Blue & William" after acquiring the site from Thirdi group in late 2021. Completion expected in H1 2023.

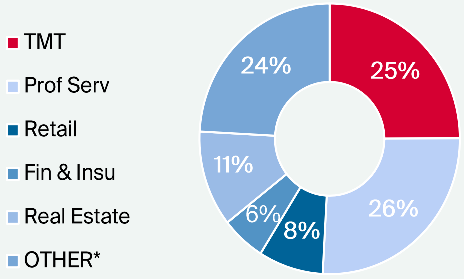
With no new significant supply anticipated until at least 2024 with Victoria Cross OSD, the market is well placed to absorb the current availability of stock especially in the prime market where tenants have previously been unable to obtain a foothold in North Sydney due to lack of availability.

Return to face rental growth

Rental growth has returned in North Sydney with average, prime net face rents having increased by 3.9% since the start of the year to measure $867/sqm ($1,019/sqm gross) as at July 2022. Similarly, secondary rents have increased at the same pace to measure $731/sqm ($874/sqm gross face). Whilst average incentives have reached a decade of 32.5%, they have remained steady since the beginning of the year, indicating they have likely peaked. This has resulted in net effective rental growth of 4% over the year to measure $535/sqm.

Lease deals by industry sector

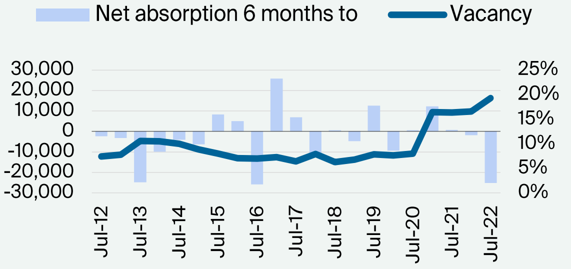
2021-2022YTD, % Share of total sqm



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

North Sydney vacancy / net absorption

Sqm, %



Source: Knight Frank Research, PCA

ST LEONARDS

Limited activity hinders vacancy levels

Lease deal activity and demand has remained fairly subdued in the St Leonards office market since the onset of the pandemic. The limited activity in conjunction with negative absorption across the secondary market has seen overall vacancy rise to 18.6% as at July 2022, up from 16.5% six months prior.

By grade, the prime market has seen a tightening in vacancy to 12.5% down from 15.2% six months prior, driven by positive absorption of 3,218sqm. Given the completion of 7 Westbourne Street (7,388sqm) by Dexus and 500 Pacific Highway (3,285sqm) over the last 18 months, both adding to new supply levels in conjunction with pockets of sub lease and direct vacancy across multiple buildings this has kept prime vacancy above the 10 year average of 9%. In the secondary market, vacancy remains high following negative absorption of 10,231sqm over the last six months, with the secondary vacancy rate now measuring 21.9% as at July-22.

Thriving healthcare precinct and new metro to drive future demand

The North Shore health care precinct is tracking towards a world class $1 billion healthcare and educational hub and is leading the way for healthcare-related real estate to be recognised as an institutional investment target rather than a boutique asset class. This will not only appeal to investors but also have a positive impact on demand with occupiers, seeking prime grade amenity in proximity to a health and education precinct.

Furthermore, the mixed use development currently under construction at 558 Pacific Highway by JQZ, will add a further 16,000sqm of prime office space in conjunction with new retail amenity and improved public domain for St Leonards to the market in H1 2023. With the Crows Nest Metro station to be delivered by the end of 2024 this will only enhance the appeal of the precinct to occupiers. With the increased prime grade availability and the arrival of new stock there will be strong appeal to occupiers in secondary assets to upgrade, which will likely see a greater divergence between the prime and secondary grade.

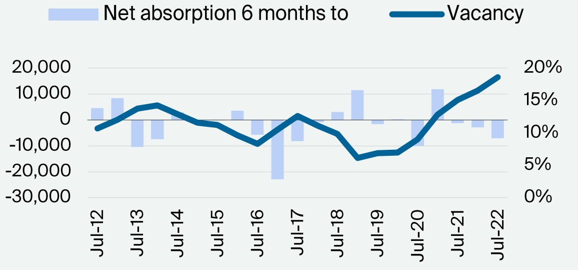
Rents increase and incentives remain stable

As being experienced across multiple markets face rents have started to increase whilst incentives are still holding firm. Average prime net face rents currently measure $646/sqm ($785/sqm gross) an increase of 1.9% over the last six months, with incentives still holding at 33% and have likely peaked. In the secondary market average net face rents measure $568/sqm ($687/sqm gross) as at July 2022, an increase of 1.8% over the last six months.

Pressure on net effective rents has now eased with incentives stabilising. In the 12 months to July 2022 net effective rents have increased by 1.8% to measure $387/sqm, this is a vast improvement on the double digit declines experienced in late 2020. Similarly in the secondary market, net effective rents have begun to increase by 1.6% over the last 12 months to measure $341/sqm. With an improved outlook for demand over the next 12-24 months on the back of new prime stock and Crows Nest Metro Station effective rents will begin to bounce back.

St Leonards vacancy and net absorption

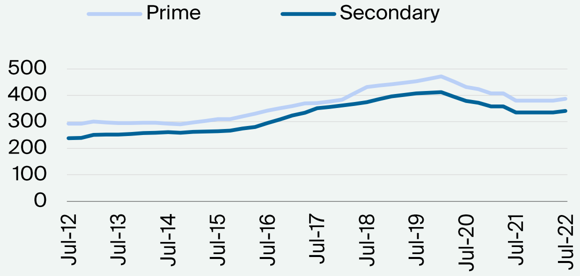
Sqm, %



Source: Knight Frank Research, PCA

St Leonards net effective rent

Average rent by grade, $/sqm



Source: Knight Frank Research

CHATSWOOD

Limited tenant activity continues to impact vacancy levels

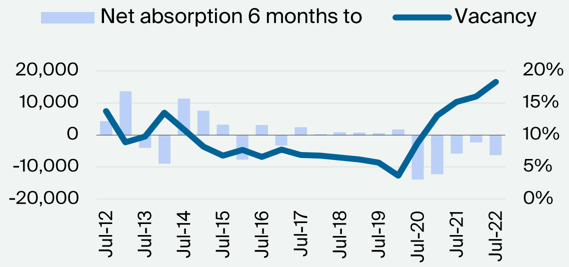
Subdued tenant activity in the Chatswood office market over the last two years, in conjunction with rising sublease availabilities, have been the catalyst for overall vacancy more reaching a decade high level.

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 now measures 18.2% as at July 2022. Both prime and secondary grades recorded an increase in vacancy over the period, with total net absorption declining by 6,280sqm in the six months to July 2022

More specifically, sublease vacancy has risen to 2.7% as at July 2022, this being a sharp rise from the zero sub lease availability in January 2020. The rise in sublease vacancy stems from the availability of several whole floors at 799 Pacific Highway (Citadel towers) and 821 Pacific Highway (Zenith Towers).

The relocation of the NSW Department of Health to St Leonards and Transport NSW to Macquarie Park from the Zenith Towers over the last two years has been the catalyst for the large backfill arising in the towers and contributing to the rise in vacancy. A large portion of this space has since been secured by Dell, with Arrow capital announcing last year that Dell will occupy 5,200sqm over a long term lease, which will see Dell consolidate from multiple offices in Frenchs Forest, St Leonards and Macquarie Park. This will provide a positive boost for absorption levels and likely see the vacancy rate tighten.

Chatswood vacancy and net absorption
Sqm, %



Source: Knight Frank Research, PCA

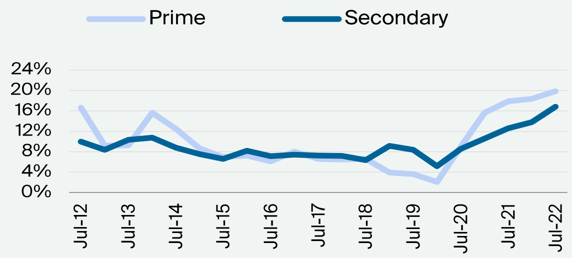
Face rents increase

Similar to competing markets in the North Shore, face rents have risen across Chatswood for the first time in two years, whilst incentives continue to hold well above average levels.

On a 12 month basis (to July 2022), average prime net face rents have increased by 2.4% to measure $592/sqm ($730/sqm gross face). Similarly, secondary rents have shifted by 1.3% in the 12 months to July 2022 to $503/sqm ($625/sqm gross face). Whilst prime rents are averaging $592/sqm there is a large disparity across the market between the lower end and upper end of prime stock, specifically with the Zenith Tower, which is best in class in Chatswood and currently achieving rents in excess of $725/sqm.

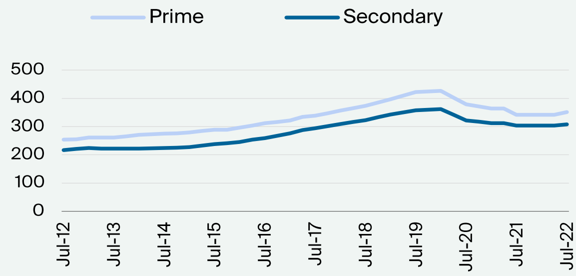
With a rise in face rents and prime incentives holding firm at 33%, net effective rents have increased by 2.7% to measure $351/sqm, in the 12 months to July 2022. Average secondary incentives have peaked at 31.2%, increasing net effective rents by 1.5% to $308/sqm on a 12 month basis.

Chatswood vacancy
By grade, %



Source: Knight Frank Research, PCA

Chatswood net effective rents
Average rent by grade, $/sqm



Source: Knight Frank Research

MACQUARIE PARK

Vacancy remains below competing North shore markets

Vacancy increased to 10.4%, as at July 2022, up from 9.8% over the last six months and up from 9.3% at the same time last year. By building grade, prime vacancy increased to 9.2% up from 8.2% in the six months to July 2022. Secondary vacancy remained steady at 13.2% as at July 2022.

Despite the overall vacancy rate increasing, it is still considerably lower than its competing North Shore markets. With Macquarie Park supported by well-established industry clusters including government, tech pharma and biotech occupiers it has made it one of the most resilient office markets despite the economic uncertainty and covid pandemic over the last two years. Over the last 18 months leasing activity has been led by the manufacturing and tech sector accounting for 58% of deal volumes.

New development stock to offer prime grade space at competitive discount to competing markets

Macquarie Park is the third largest metropolitan market in NSW, just behind Parramatta and North Sydney with 909,469sqm of office stock, with prime stock accounting for 70% of the total stock base in Macquarie Park, a higher proportion than both the Sydney CBD and North Sydney. With a healthy development pipeline this will continue to grow.

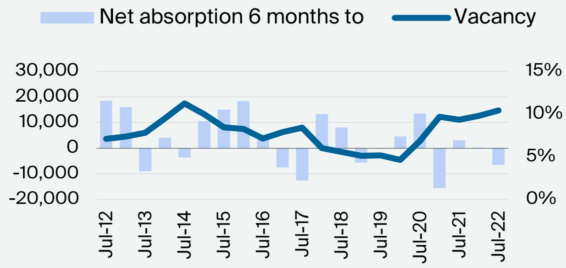
Construction is well underway at the Macquarie Exchange development at 396 Lane Cove Road. Stage 1 due for completion will deliver a c18,000sqm prime office building. Frasers and Winten Property Group sold the building to Ascendas REIT in September 2020 for $167.2 million, agreeing to provide a three-year rental guarantee from completion of the property for any vacant spaces.

Furthermore, Stockland has commenced construction at its project M_Park at 11-17 Khartoum Road, the site spans over 3Ha and will become a vibrant commercial and retail precinct. Stage 1 will deliver 16,920sqm of prime office space with a typical floor plate of 1,800sqm. This building will become the new consolidated Australian Headquarters for Johnson and Johnson with completion scheduled in 2023.

Rents increase and incentives hold firm

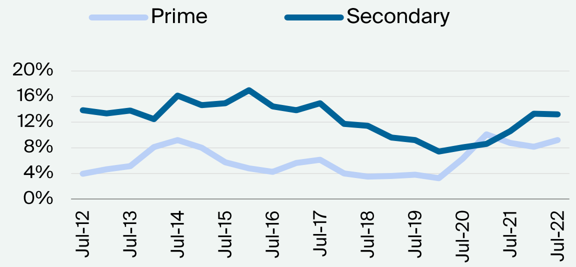
On a 12 month basis (to July 2022), average prime net face rents have increased by 2.4% to $430/sqm ($540/sqm gross face). Similarly, secondary rents have increased by 1.4% in the 12 months to July 2022 to $363/sqm ($473/sqm gross face). Incentives have held firm at 30% which has resulted in prime net effective rents increasing by 2.4% to measure $305/sqm.

Macquarie Park vacancy and net absorption
Sqm, %



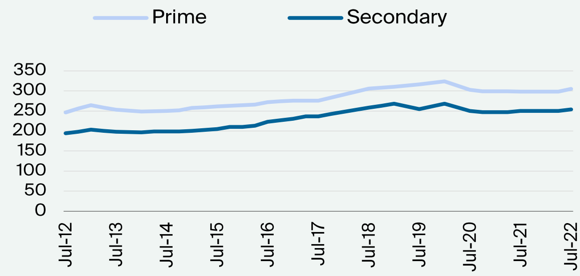
Source: Knight Frank Research, PCA

Macquarie Park vacancy
By grade, %



Source: Knight Frank Research, PCA

Macquarie Park net effective rents
Average rent by grade, $/sqm



Source: Knight Frank Research

NORTH SHORE INVESTMENT

Higher funding costs impacting sentiment

While economic growth remains strong, rising inflation locally and globally has resulted in significant uncertainty over the outlook for interest rates and whether central banks will be able to act quickly enough to rein in these cost pressures while also engineering a soft landing. The RBA has now raised rates by 50 bps on several occasions with further hikes expected in coming months. However, for property markets, the cash rate is merely playing catch-up with the sharp uplift in bond yields and swap rates witnessed since January.

The sharp increase in bond yields across all maturities has had a commensurate impact on swap rates and hence the cost of debt in property markets, with funding costs rising by more than 200 basis points in most cases. This has also had the impact of raising the cost of hedging currency exposures for foreign investors.

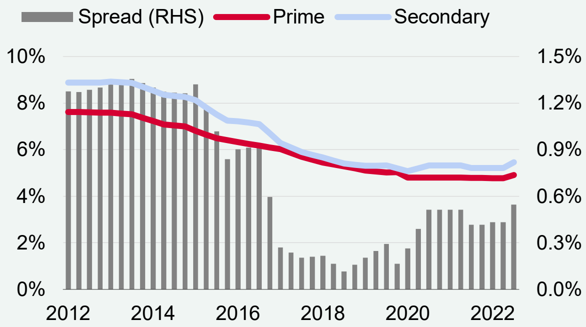
These changes in financial conditions are now impacting market sentiment and have caused a slowing in transactional activity as vendors and buyers reset expectations. Reflecting this shift, deal volumes across the North Shore stand at a relatively low $746 million so far this year, with activity focussed on North Sydney and Macquarie Park. The largest deal of the year so far was the purchase by CapitaLand of 101 Miller Street for $330 million, which was agreed before the change in market conditions.

Prime yields still holding at low levels, reflecting sustained investor demand despite the pandemic

The impact of higher funding costs on pricing is starting to become apparent; however, it is too early to judge the full impact especially as further rate rises are still to come. Average prime yields in the benchmark North Sydney market have shifted up by 12.5 basis points to 4.9%, while secondary yields have seen a larger 25 basis point adjustment to stand at 5.45%. The larger impact on pricing for secondary assets reflects greater caution over the outlook amidst higher rates and also elevated vacancy rates in secondary markets, which means they are subject to more leasing risk than prime assets.

The yield widening trend is echoed nationally and in other global markets given the universality of inflationary pressures and rate rises, but Sydney will remain a preferred destination for investors aided by the nascent return of rental growth.

North Sydney office yields



Source: Knight Frank

Recent significant sales

PROPERTY	PRICE $M	CORE MARKET YIELD %	NLA SQM	$/SQM NLA	WALE	PURCHASER	VENDOR	SALE DATE
15 Talavera Road, Macquarie Park	111.4	5.39	12,646	8,813	2.2	LaSalle Investment Management	ESR	Aug-22
165 Walker Street, North Sydney	68.8	5.0	5,200	13,231	1.5	Roxy Pacific	Intera Group	Jun-22
51 Berry Street, North Sydney	66.3	4.65	3,541	18,724	4.1	Private	Property Bank Australia*	Mar-22
101 Miller Street, North Sydney (50%)	330^	5.16	37,473	17,613	3.6	CapitalLand Integrated Commercial Trust	Nuveen Real Estate	Jan-22
75 Miller Street, North Sydney	65.5	5.06	4,930	13,286	2.5	Private	Huge Linkage Limited	Dec-21

*Property bank Australia and Security capital Corporation ^Price excludes Greenwood Plaza retail component

North Shore development pipeline

Address	Region	Area (sqm)	Developer	Major Tenants	Commitment level (%)	Stage	Est. Date of Compl
88 Walker Street	North Sydney	13,000	Billbergia	-	-	U/C	H1 2023
558 Pacific Highway	St Leonards	16,738	JQZ	-	-	U/C	H1 2023
2-4 Blue Street	North Sydney	14,000	Lendlease/ Keppel REIT	-	-	U/C	H2 2023
Macquarie Exchange Stage 1, 396 Lane Cove Road	Macq Park	18,000	Frasers/Winten	-	-	U/C	H2 2022
Array, 1 Eden Park drive	Macq Park	10,000	Kador group	-	-	U/C	H2 2022
M_Park Stage 1, 11 Khartoum Road	Macq Park	16,920	Stockland	Johnson & Johnson	-	U/C	2023
Victoria Cross OSD	North Sydney	55,000	Lendlease	-	-	U/C	H2 2024
173 Pacific Highway	North Sydney	11,000	Maville Group	-	-	DA Approved	2025+
61-68 Walker Street	North Sydney	29,000	Thirdi	-	-	DA Approved	2025+
105 Miller Street	North Sydney	74,000	Investa/Oxford	-	-	DA Approved	2025+
110 Walker Street	North Sydney	60,000	Stockland	-	-	DA Applied	2025+

Recent significant tenant commitments

OCCUPIER	PROPERTY	MARKET	SIZE SQM	FACE RENT $/SQM (n)	INCENTIVE (%)	TERM YRS	START DATE
Aurecon~	73 Miller Street	North Sydney	4,515	960	39	9.6	Jul-22
Luxottica	1 Denison Street	North Sydney	3,187	1,000	34.5	5	Jun-22
Till Payments~	78 Waterloo Road	Macq Park	1,800	440	30	7	Apr-22
Cincom~	39 Delhi Road	Macq Park	286	410	28	3	Feb-22
Finclear~	118 Mount Street	North Sydney	900	895	32	5	Jan-22
Petbarn~	1 Epping Road	North Ryde	2,706	365	30	5	Jan-22

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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