

- *Positive demand for best in class assets*
- *Continued rental growth*
- *Yields softening across all markets*



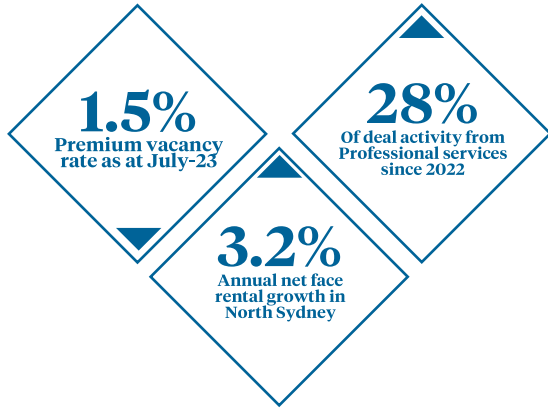
# North Shore Office

Market Report, August 2023

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# PREMIUM MARKET OUTPERFORMS



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“Occupier demand continues to be driven by flight to quality”

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## The Key Insights

Occupier demand in North Sydney continues to be driven by the flight to quality trend with the top end assets performing well compared to secondary stock.

The recently completed 2-4 Blue Street (14,500sqm) by Lendlease is the first office completion in North Sydney since the end of 2020.

North Sydney premium market remains resilient and stronger than ever, with premium grade vacancy sitting at 1.5%, down from 2.9%.

The average prime and secondary yields in the North Sydney market have expanded 88bps and 163bps over 12 months to 5.8% and 7.1% respectively .

## North Shore Office Market Indicators—July 2023

| MARKET                | GRADE        | TOTAL STOCK SQM | VACANCY RATE % | SIX MONTH NET ABSORPTION SQM | SIX MONTH NET ADDITIONS SQM | AVERAGE NET FACE RENT \$/ SQM | INCENTIVE % <sup>^</sup> | CORE MARKET YIELD % <sup>*</sup> |
|-----------------------|--------------|-----------------|----------------|------------------------------|-----------------------------|-------------------------------|--------------------------|----------------------------------|
| North Sydney          | Prime        | 379,036         | 17.5           | -7,382                       | 14,500                      | 894                           | 33-38                    | 5.50-6.25                        |
| North Sydney          | Secondary    | 553,607         | 26.2           | -13,454                      | 0                           | 731                           | 33-38                    | 6.75-7.25                        |
| <b>North Sydney</b>   | <b>Total</b> | <b>932,643</b>  | <b>22.7</b>    | <b>-20,836</b>               | <b>14,500</b>               |                               |                          |                                  |
| St Leonards           | Prime        | 135,323         | 26.6           | 3,352                        | 16,738                      | 654                           | 33-38                    | 6.75-7.25                        |
| St Leonards           | Secondary    | 222,301         | 22.9           | -2,142                       | 0                           | 573                           | 30-35                    | 7.50-8.00                        |
| <b>St Leonards</b>    | <b>Total</b> | <b>357,624</b>  | <b>24.3</b>    | <b>1,210</b>                 | <b>16,738</b>               |                               |                          |                                  |
| Chatswood             | Prime        | 129,730         | 17.6           | 3,653                        | 0                           | 622                           | 33-38                    | 6.75-7.25                        |
| Chatswood             | Secondary    | 141,273         | 14.8           | 2,143                        | 0                           | 513                           | 30-35                    | 7.50-8.00                        |
| <b>Chatswood</b>      | <b>Total</b> | <b>271,003</b>  | <b>16.1</b>    | <b>5,796</b>                 | <b>0</b>                    |                               |                          |                                  |
| Macquarie Park        | Prime        | 621,703         | 14.7           | -24,006                      | -9,297                      | 453                           | 30-35#                   | 6.50-7.00                        |
| Macquarie Park        | Secondary    | 271,549         | 16.7           | -12,981                      | -6,320                      | 375                           | 30-35#                   | 7.25-7.75                        |
| <b>Macquarie Park</b> | <b>Total</b> | <b>893,252</b>  | <b>15.3</b>    | <b>-36,987</b>               | <b>-15,617</b>              |                               |                          |                                  |

Source: Knight Frank Research/PCA <sup>\*</sup>assuming WALE 5.0 years <sup>^</sup>Incentives are on a Gross basis <sup>#</sup>Incentives are on a net basis

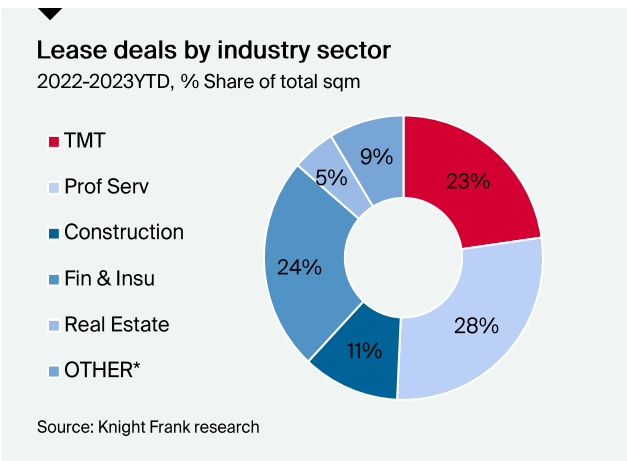
# NORTH SYDNEY

## Positive demand for premium assets

Occupier demand in North Sydney continues to be driven by the flight to quality trend with the top end assets performing exceptionally well compared to secondary grade stock which hinders overall vacancy levels for North Sydney. Total vacancy in North Sydney increased over the last six months to measure 22.7% as at July 2023.

The premium market remains resilient and stronger than ever, with premium grade vacancy sitting at 1.5%, down from 2.9% in the six months to July 2023. Hollard insurance has recently relocated from Chatswood into 100 Mount Street, securing 7,096sqm taking the asset to 99.8% occupancy. Notably, the commitment by Hollard Insurance achieved a considerable increase to the previous passing rent, a further illustration of the flight to quality trend. Similarly, 1 Denison is sitting at near full occupancy, whilst, 118 Mount Street is now over 80% committed, emphasising the demand and flight to quality trend for top end assets. Furthermore, the recently completed development by Lendlease at 2-4 Blue Street has achieved near 50% occupancy, anchored by Equifax (4,350sqm), consolidating from two locations at 90 Arthur Street and 100 Arthur street.

Lease deal volumes over the last 18 months have been driven by professional services accounting for 28% of deal activity, followed by financial and insurance services 24% and the tech sector with 23% of total take up volumes. There has been strong tenant enquiry for premium assets where there is minimal availability and deal flow activity is expected to pick up with a number of deals at final stages of being signed according to market sources.



## Market well placed to absorb current stock levels

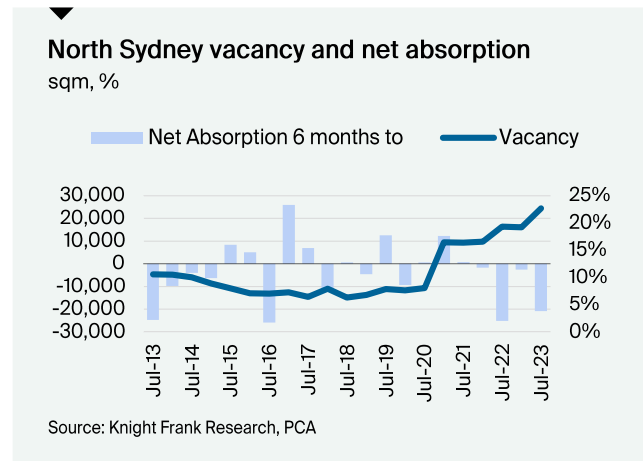
The recently completed 2-4 Blue Street (14,500sqm) by Lendlease is the first office completion in North Sydney since the end of 2020. North Sydney is the second largest metropolitan office market in NSW; with a stock base totalling 932,643 sqm of which prime grade stock accounts for 41% of the market, up from 25% ten years ago.

Only two other developments are under construction; including 88 Walker Street, which will encompass 12,500sqm of commercial space across a mixed use development, due for completion imminently. Additionally, the Lendlease developed Victoria Cross OSD (55,000sqm) is well under construction and due for completion in the first half of 2025.

Beyond these two, there are a number of DA approved and pre-commit led developments in the pipeline including Afinity Place (59,000sqm), 173 Pacific Highway and 155 Walker Street. These schemes if progressed would be delivered beyond 2028, allowing for current stock levels to be absorbed by the market.

## Rental growth in prime market

There has been positive face rental growth across North Sydney, average prime net face rents have increased by 3.2% over the year to measure \$894/sqm (\$1,047/sqm gross) as at July 2023. In contrast the secondary market has been subdued with no rental growth recorded over the year as average net face rents currently measure \$731/sqm (\$874/sqm gross face). Incentives have stabilised around 35% which has resulted in little movement in prime net effective rents averaging \$527/sqm.



# ST LEONARDS

## Subdued occupier demand

Occupier demand in St Leonards has remained subdued since the onset of the pandemic, the market has struggled to bounce back post Covid-era. With one of the largest development completions in a decade to enter the market at a time of constrained demand, overall vacancy has risen to its highest level on record of 24.3% as at July 2023.

By grade, the prime market has seen an increase in vacancy to 26.6% up from 19.1% over the six months to July 2023, this was driven by 16,738sqm of new supply from 558 Pacific Highway. Adding to 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 12.5%. In the secondary market, vacancy remains elevated at 22.9%, up slightly from 21.9% in the six months to July 2023.

## State of the art healthcare precinct and new metro to aid future demand

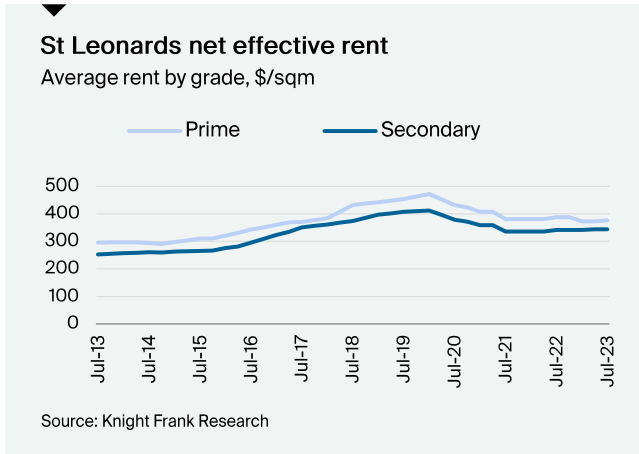
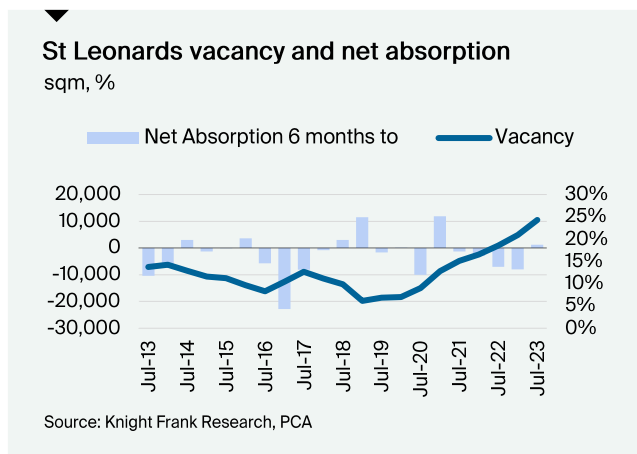
The North Shore health care precinct is tracking towards a world class \$1 billion healthcare and educational hub and is leading the way for healthcare-related real estate to be recognised as an institutional investment target rather than a boutique asset class. This will not only appeal to investors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

Furthermore, the recently completed mixed use development at 558 Pacific Highway by JQZ, has added a further 16,738sqm of prime office space in conjunction with new retail amenity and improved public domain for St Leonards to the market. With the Crows Nest Metro station to be delivered in 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.

## Moderate rental growth

Given the high vacancy levels and subdued demand across St Leonard’s rental growth has not been as prominent compared to competing North Shore markets. Average prime net face rents currently measure \$654/sqm (\$793/sqm gross) an increase of 1.2% over the 12 months to July 2023. Landlords have kept incentives elevated averaging 35%. In the secondary market average net face rents measure \$573/sqm (\$692/sqm gross) as at July 2023, an increase of 0.9% over the year.

Prime net effective rents have increased by 0.9% over the six months to July 2023 to measure \$376/sqm, this is a vast improvement on the double digit declines experienced in late 2020. Similarly, in the secondary market net effective rents have increased 0.9% in the six months to July 2023 to average \$344/sqm. With the new Crows Nest Metro station in 2024 to improve connectivity to the area there is potential for a bounce back in rents over the next 12-24 months.



# CHATSWOOD

## Only North Shore market to see a fall in vacancy over the first half of 2023

Chatswood is the only North Shore market that reported a decline in vacancy in the first half of 2023. Overall vacancy in Chatswood measures 16.1% as at July 2023, down from the decade high of 18.3% in January 2023. The decline in vacancy is a result of positive net absorption of 5,796 sqm in the six months to July 2023.

More specifically, the prime market has experienced vacancy tightening from 20.1% to 17.6% over the six months to July 2023, driven by positive net absorption of 3,653 sqm. Similarly, the secondary vacancy decreased to 14.8%, down from 16.3% six months prior, with a positive net absorption of 2,143 sqm.

With the stock remaining unchanged for six months to July 2023, positive leasing activity supported the vacancy dropping. Notable leasing deals include Nutricia's relocation from Macquarie Park to Zenith Towers absorbed c. 1,000 sqm of prime space. Additionally, there have been several sub 1,000sqm deals across the market which have aided the positive absorption levels.

Since the beginning of 2022, Tech sector and professional services have dominated the leasing volumes by contributing a combined 58% of take-up activity, followed by manufacturing (11%) and administrative services (10%).

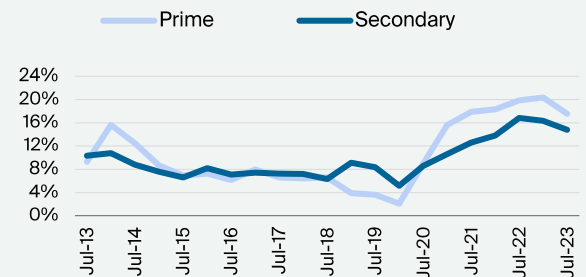
## Continued rental growth for best in class assets

On a 12 month basis (to July 2023), average prime net face rents in Chatswood have increased by 5.1% to \$622/sqm (\$760/sqm gross face), notable the best in class Zenith Towers are achieving rents in excess of \$700/sqm net. In the secondary market net face rents have risen by 2.0% to \$513/sqm (\$640/sqm gross face) over the same period. The current rental discount between prime and secondary rents sits at 18%.

Incentives for both the prime and secondary markets have increased slightly over the first half of the year to average 35% and 33% accordingly, up from 33% and 31%. The rise in incentives have softened the growth of net effective rents. Net effective rents rose 1.4% to measure \$356/sqm in the prime market, whilst net effective rents in the secondary market declined by 2.1% to measure \$302/sqm over the year to July 2023.

### Chatswood vacancy

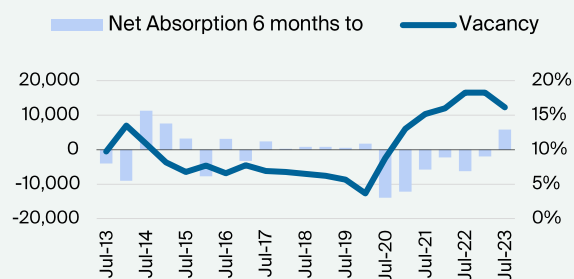
% by grade



Source: Knight Frank Research, PCA

### Chatswood vacancy and net absorption

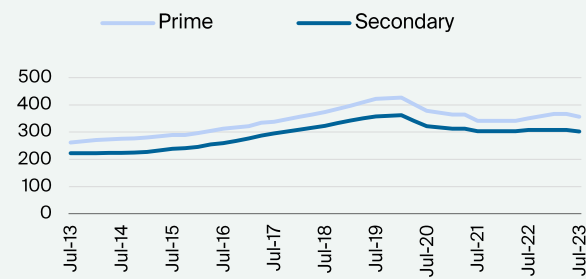
sqm, %



Source: Knight Frank Research, PCA

### Chatswood net effective rents

Average rent by grade, \$/sqm



Source: Knight Frank Research

# MACQUARIE PARK

## Vacancy climbs to record high, although still tracking below competing North Shore markets

Total vacancy in Macquarie Park continued climbing by 260bps to reach a record high of 15.3% over the first half of 2023, which is well above the 10-year average of 8.5%.

By building grade, prime vacancy increased from 12.2% to 14.7% in six months to July 2023, with negative net absorption of 24,006 sqm. Secondary vacancy increased to 16.7% in July 2023, up from 13.9% in January 2023, with 12,981 sqm of negative net absorption recorded in this period.

Despite the increasing vacancy across the market, Macquarie Park has the lowest vacancy against the rest of North Shore markets. Macquarie Park is well positioned with its solid transport infrastructure and the Innovation District planning, which continues to attract med-tech and IT tenants to the market. In the first half of 2023, 56% of take-up volume was contributed by manufacturing and tech occupiers in Macquarie Park.

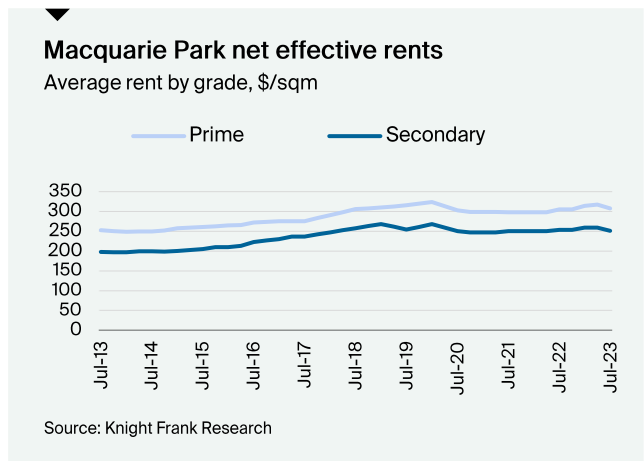
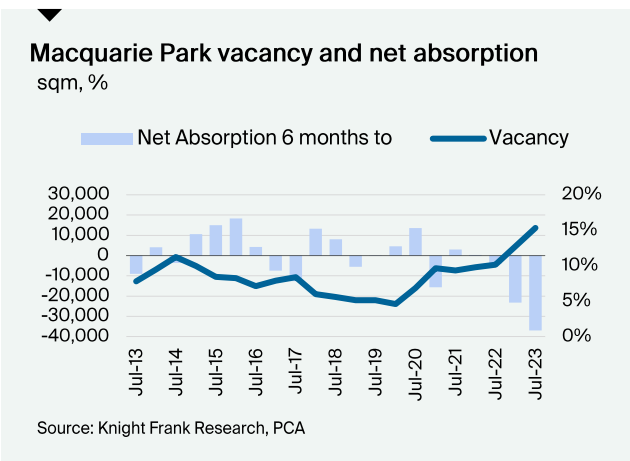
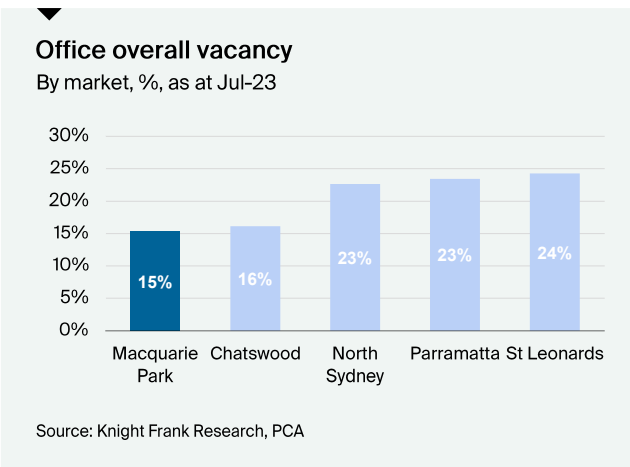
## Healthy development pipeline to offer prime space at competitive rentals

Macquarie Park remains the third largest metropolitan office market in NSW with a total stock base of 893,252, following closely behind Parramatta and North Sydney. With 70% of stock being prime space, Macquarie Park has the highest proportion of prime stock across NSW.

The healthy development pipeline in Macquarie Park is forecast to deliver c.45,000 sqm prime space to the market by the end of the year. New developments include “Array” at 1 Eden Park Drive (c.10,000 sqm), 396 Lane Cove Road (c.18,000 sqm) and the first stage of M\_Park at 11 Khartoum Road (c.16,800 sqm). In terms of withdrawals, 73 Talavera Road (9,297sqm) has been withdrawn and will undergo a major refurbishment set to be back on the market in late 2024.

## Incentives elevated to record highs

Macquarie Park achieved the highest annual increases in both prime and secondary net face rents among North Shore markets. The average net face rents saw growth of 5.2% to \$453/sqm (\$568/sqm gross face) for prime and 3.4% to \$375/sqm (\$490/sqm gross face) for secondary over the 12 months to July 2023. There was an increase in net incentives to record highs, currently ranging between 30%-35% as at July 2023. As a result, there was a only a slight increase in prime net effective rents of 0.8% to now average \$453/sqm.



# NORTH SHORE INVESTMENT

## Subdued deal flow so far this year, however activity likely to pick up on the back of clearer economic conditions

After an extended period of interest rate increases, recent RBA Board statements reflect growing confidence that the actions taken to date in raising the cash rate to 4.1% will prove sufficient to enable inflation to return to the target range of 2-3%. Forecasters are now expecting an extended pause from the RBA, which will provide a more reassuring backdrop for the property market and create the conditions for deal flow to gradually return.

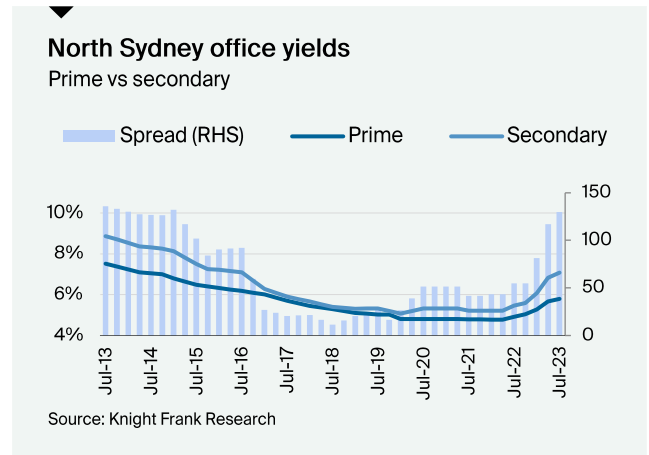
The North Shore market has seen just one transaction settled in six months to July 2023. In Macquarie Park, HMC Capital’s HealthCo Health & Wellness REIT acquired 5 Eden Park Drive for \$80.75 million from Australian Unity Office Fund in the March quarter, reflecting a c5.25% market yield.



## Yields continue softening, with the prime and secondary spread reaching decade highs

The slowing investment activity indicates the market adjustments to the high funding costs and economic uncertainties. The average prime and secondary yields in the North Sydney market have expanded 88bps and 163bps over 12 months to 5.8% and 7.1% respectively. The current yield spread between prime and secondary markets in North Sydney reaches a decade-high of 130. The widening yield spread between prime and secondary space is echoed nationally and in other global markets given the investors’ cautious sentiments on market outlook uncertainties.

The average prime yields in the rest of North Shore markets currently range between 6.75% and 7.25%, while secondary yields range between 7.50% to 8.00%. Yields would be tested more thoroughly in the following months with more transactional evidence emerging.



### Recent significant sales

| PROPERTY                                 | PRICE \$M | CORE MARKET YIELD % | NLA SQM | \$/SQM NLA | WALE | PURCHASER                         | VENDOR                       | SALE DATE |
|--|-----------|---------------------|---------|------------|------|-----------------------------------|------------------------------|-----------|
| <b>5 Eden Park Drive, Macquarie Park</b> | 80.8      | 5.25                | 11,556  | 6,988      | 3.1  | HealthCo Healthcare Wellness REIT | Australian Unity Office Fund | Feb-23    |
| <b>50 Miller Street, North Sydney</b>    | 148.0     | 5.50                | 10,357  | 14,290     | 6.9  | Sun Venture                       | Summer Capital               | Nov-22    |
| <b>73 Miller Street, North Sydney</b>    | 400.0     | 4.61                | 19,114  | 20,927     | 7.1  | Private                           | ESR                          | Aug-22    |
| <b>15 Talavera Road, Macquarie Park</b>  | 111.4     | 5.39                | 12,646  | 8,813      | 2.2  | LaSalle Investment Management     | ESR                          | Aug-22    |
| <b>165 Walker Street, North Sydney</b>   | 68.8      | 5.00                | 5,200   | 13,231     | 1.5  | Roxy Pacific                      | Intera Group                 | Jun-22    |

## North Shore development pipeline

| Address   | Region       | Area (sqm) | Developer             | Major Tenants | Commitment level (%) | Stage       | Est. Date of Compl |
|---|--------------|------------|-----------------------|---------------|----------------------|-------------|--------------------|
| <b>2-4 Blue Street</b>                                | North Sydney | 14,500     | Lendlease/Keppel REIT | Equifax       | 50%                  | Complete    | H1 2023            |
| <b>558 Pacific Highway</b>                            | St Leonards  | 16,738     | JQZ                   | -             | -                    | Complete    | H1 2023            |
| <b>88 Walker Street</b>                               | North Sydney | 13,000     | Billbergia            | -             | 10%                  | U/C         | H2 2023            |
| <b>Macquarie Exchange Stage 1, 396 Lane Cove Road</b> | Macq Park    | 18,000     | Frasers/Winten        | -             | -                    | U/C         | H2 2023            |
| <b>Array, 1 Eden Park Drive</b>                       | Macq Park    | 10,000     | Kador group           | -             | -                    | U/C         | H2 2023            |
| <b>M_Park Stage 1, 11 Khartoum Road</b>               | Macq Park    | 16,920     | Stockland             | -             | -                    | U/C         | H2 2023            |
| <b>Victoria Cross OSD</b>                             | North Sydney | 55,000     | Lendlease             | -             | -                    | U/C         | H1 2025            |
| <b>105 Miller Street#</b>                             | North Sydney | 26,980     | Investa/Oxford        | -             | -                    | DA Approved | H2 2026            |
| <b>Afinity Place</b>                                  | North Sydney | 59,000     | Stockland             | -             | -                    | DA Approved | H1 2028            |
| <b>173 Pacific Highway</b>                            | North Sydney | 11,000     | Maville Group         | -             | -                    | DA Approved | 2028               |
| <b>155 Walker Street</b>                              | North Sydney | 45,000     | GPT                   | -             | -                    | Mooted      | 2030+              |
| <b>63-83 Walker Street</b>                            | North Sydney | 27,966     | Thirdi                | -             | -                    | Mooted      | 2030+              |

# Refurbishment

## Recent significant tenant commitments

| OCCUPIER                    | PROPERTY            | MARKET       | SIZE SQM | FACE RENT \$/SQM (n) | INCENTIVE (%) | TERM YRS | START DATE |
|-----------------------------|---------------------|--------------|----------|----------------------|---------------|----------|------------|
| <b>Nutricia ~</b>           | 821 Pacific Highway | Chatswood    | 1,037    | 745                  | 33%           | 5        | Sep-23     |
| <b>Autism Spectrum ~</b>    | 821 Pacific Highway | Chatswood    | 750      | 685                  | 40%           | 6        | Jul-23     |
| <b>MLC Life Insurance ~</b> | 177 Pacific Highway | North Sydney | 2,474    | 840                  | 40%           | 10       | Jul-23     |
| <b>AirTrunk #</b>           | 88 Walker Street    | North Sydney | 1,296    | 1,375                | 35%           | 7        | H2 23      |

# Pre-commitment ~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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