RESEARCH

OCTOBER 2012

NORTH SHORE

Office Market Overview

Knight Frank

HIGHLIGHTS

- Tight leasing conditions continue to support the North Shore office market, however the strong rental growth achieved at the end of 2011 and beginning of 2012 has started to moderate. Although some moderation in employment growth and some forthcoming sub lease space are likely to see an easing in tenant demand in the next 12 months, rental growth is forecast to continue at a rate slightly above CPI given the lack of leasing options, particularly for prime space.
- The sharp falls in vacancies over the last two years are also expected to moderate with vacancy rates set to decline at a more gradual pace over FY2013 and FY2014. Approximately three quarters of the very limited amount of forthcoming supply over the next two years is pre-committed, which will minimise any supply driven pressure on the vacancy rate in the next two years.
- Sales transaction activity in 2012 has been steady, with the majority of sales occurring amongst upper B grade assets. Buyer depth is being underpinned by larger syndicates and high net worth privates, however with AREIT trading prices closer to NTA and the large spread between bonds and property yields, there is scope for institutional interest to improve. Prime core market yields have held broadly steady in 2012.

NORTH SHORE OFFICE OVERVIEW

Table 1
North Shore/North Ryde Office Market Indicators as at October 2012

Market	Grade	Total Stock (m²)^	Vacancy Rate (%) ^	Annual Net Absorption (m²)^	Avg Net Face Rent ($/m²)	Outgoings ($/m²)	Average Incentive (%)	Average Core Market Yield (%)
North Sydney	Prime	222,796	2.3	4,199	606	112	22.5*	7.25 - 8.00
North Sydney	Secondary	638,357	9.2	10,224	478	110	30.0*	8.75 - 9.25
North Sydney	**Total Market**	**861,153**	**7.4**	**14,423**	**511**	**111**	**28.1***	**7.25 - 9.25**
Crows Nest/St Leonards	Prime	88,599	7.5	6,414	466	108	30.0*	8.00 - 8.75
Crows Nest/St Leonards	Secondary	265,027	11.8	-11,004	379	99	32.0*	9.00 - 9.75
Crows Nest/St Leonards	**Total Market**	**353,626**	**10.7**	**-4,590**	**401**	**101**	**31.5***	**8.00 - 9.75**
Chatswood	Prime	157,412	16.7	6,152	410	104	30.0*	8.50 - 9.25
Chatswood	Secondary	123,433	10.0	-275	356	95	31.8*	9.50 - 10.25
Chatswood	**Total Market**	**280,845**	**13.7**	**5,877**	**386**	**100**	**30.8***	**8.50 - 10.25**
North Shore	**Total Market**	**1,495,624**	**9.4**	**15,710**	**461**	**107**	**29.4***	**7.25 - 10.25**
North Ryde/Macquarie Park	Prime	562,308	4.0	34,383	320	85	20.0‡	8.00 - 8.75
North Ryde/Macquarie Park	Secondary	258,103	12.7	-227	283	95	30.0‡	9.00 - 10.00
North Ryde/Macquarie Park	**Total Market**	**820,411**	**6.7**	**34,156**	**308**	**88**	**23.1‡**	**8.00 - 10.00**
Core Market Yield:	The percentage return/yield analysed when the assessed fully leased net market income is divided by the adopted value/price which has been adjusted to account for property specific issues (i.e. rental reversions, rental downtime for imminent expiries, capital expenditure, current vacancies, incentives, etc).							
Grade:	Prime includes modern and A-Grade stock whilst secondary includes B, C and D quality Grade.							

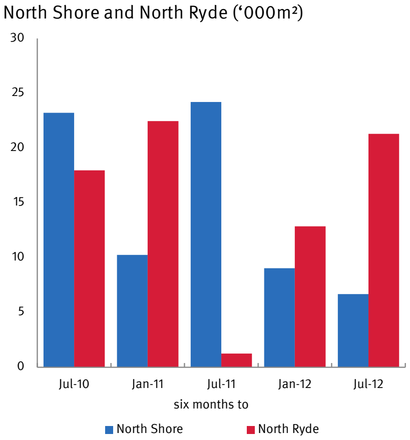
Source: Knight Frank Research/PCA ^ as at July 2012 *Incentives are on a Gross basis ‡ Incentives are on a Net basis NB. Average data is on a weighted basis
Yield ranges reflect the average lower and average upper yields for a select basket of office assets in each market and Grade

Tightening vacancy rates, particularly for prime grade stock over the past two years has underpinned strong rental growth in the North Shore and North Ryde office markets since the start of 2011. The six months to October 2012 saw a continuation of positive rental growth, albeit at a moderating rate. Similarly, as per Figure 1, net absorption in the North Shore has also shown some signs of slowing. While this has been consistent with moderating job advertisements and expectations for flat to mild employment growth, softer absorption figures have also partly been caused by the lack of leasing alternatives for prospective tenants. Conversely, in the six months to July, North Ryde posted its second consecutive half yearly increase in net absorption, a result that was supported by pre-committed supply entering the market.

Despite the tight leasing market, particularly for prime and upper B-grade stock, the supply of new developments remains limited. This is particularly the case in North Sydney, where despite a 2.3% prime vacancy rate, a number of DA approved projects remain on hold until sufficient pre-commitment can be attained. Although both North Ryde and Crows Nest/St Leonards are set to experience some new supply in the coming year, the majority of this is pre-committed to expanding or incoming tenants and will therefore have a relatively small impact on the vacancy rate. Aside from some office space incorporated in Mirvac's ERA residential project, Chatswood remains reliant on refurbishments for new supply.

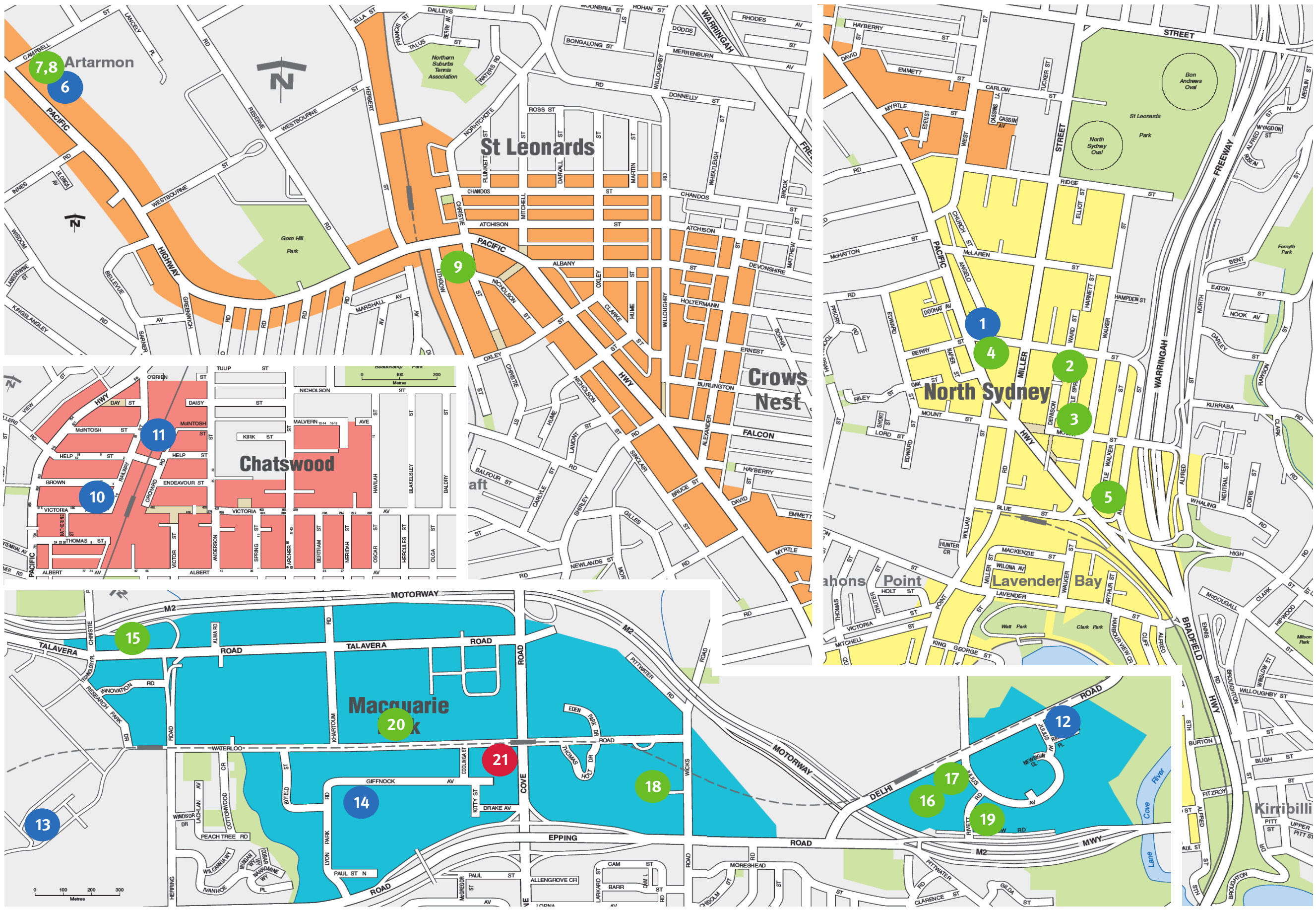
Further progression of the development pipeline will be dependent upon tenant pre-commitments and project funding, meaning additional significant completions are unlikely for another three years. This is set to see vacancy rates remain persistently tight over the coming two years. Despite the base case forecast for white collar employment growth over the coming two years being below trend, this is expected to underpin a continuation of the steady rental growth.

Figure 1
Net Absorption
North Shore and North Ryde ('000m²)



Source: PCA

MAJOR OFFICE SUPPLY



Source of Map: Knight Frank

North Sydney

1 — 20 Berry St# - 2,642m²
Velment Pty Ltd Q1 2013

2 — 77-81 Berry St - 46,135m²
Eastmark Holdings 2015+

3 — 100 Mount St - up to 40,000m²
Laing O'Rourke 2015+

4 — 177-199 Pacific Hwy - 38,000m²
Winten Property Group* 2015+

5 — 80 Arthur Street - 15,808m²
Medi-Aid Centre Foundation 2015+

Crows Nest/St Leonards

6 — Gore Hill Building C - [Fox Sports 48%]
Lindsay Bennelong Dev. 14,136m² - Q4 2012

7 — Gore Hill Building D1 - 16,000m²
Lindsay Bennelong Development 2015+

8 — Gore Hill Building D2-3 - 42,000m²
Lindsay Bennelong Development 2016+

9 — 88 Christie St, St Leonards - 28,500m²
Winten Property Group* 2016+

Chatswood

10 — 465 Victoria Avenue# - 15,000m² [VHA]
FKP Q3 2012 - 100% committed

11 — 7 Railway St - 4,900m²
Mirvac Q2 2014

North Ryde/Macquarie Park

12 — 105 Delhi Road - 10,270m² [DIISR]
Goodman Q2 2012 - 100% committed

13 — 16 University Dr - 19,538m² [Macquarie Uni]
Macquarie Uni Q1 2013 - 74% committed

14 — 22 Giffnock Avenue - 9,700m² [Optus]
Goodman Q2 2013 - 100% committed

15 — 112 Talavera Rd - 12,000m²
DEXUS 2014+

16 — 27-37 Delhi Road - 32,000m² (4 buildings)
Goodman 2015+

17 — 39 Delhi Rd - 30,000m²
Stockland 2015+

18 — 144 Wicks Rd - 27,340m²
DEXUS^ 2016+

19 — 1 Rivett Rd - 11,380m²
Pathway Property 2016+

20 — 63-71 Waterloo Rd - 11,822m²
Capital Corporation 2017+

21 — 396 Lane Cove Rd - 79,736m²
Winten and Australand 2017+

Under Construction/Complete

DA Approved/Confirmed/Site Works

Mooted / Early Feasibility

NB. Dates are Knight Frank Research estimates

Major refurbishment

Office NLA quoted

Major tenant precommitment in brackets

VHA refers Vodafone Hutchison Australia

DIISR refers Department of Innovation, Industry, Science and Research

* for sale

^ Site for sale with Stage 1 Masterplan Approval

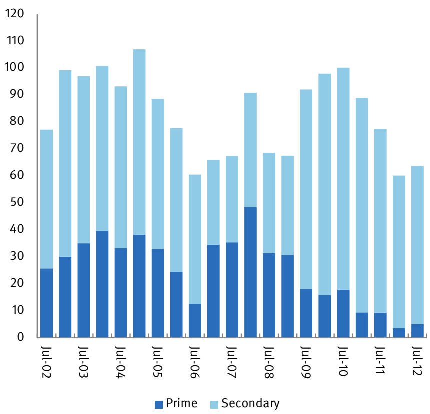
NORTH SYDNEY

Leasing Market and Rents

After four consecutive six monthly periods of positive tenant demand, the six months to July 2012 saw North Sydney record negative net absorption of 2,285m², which resulted in the vacancy rate increasing from 7.0% to 7.4%. The result was driven by the 3,856m² increase in sub lease vacancy, which took the sub-lease vacancy rate to 0.8% (from 0.3% previously). Prime vacancies remain particularly low at 2.3% or 5,096m² (refer Figure 2).

Although current sub-lease vacancy remains low at 6,519m², it is anticipated that this number will increase in the forthcoming year to closer to 20,000m². The predominant driver of this projection is the consolidation of NAB into 105 Miller Street, which will involve around 10,000m² of sub-lease space at 50 Miller Street being given back to the market. Despite the expected increase in the amount of sub-lease space hitting the market, the relatively short lease terms on offer of mostly less than five years will have little impact on rents and growth as tenants seek longer term leases thus ruling out many of the available sublease options.

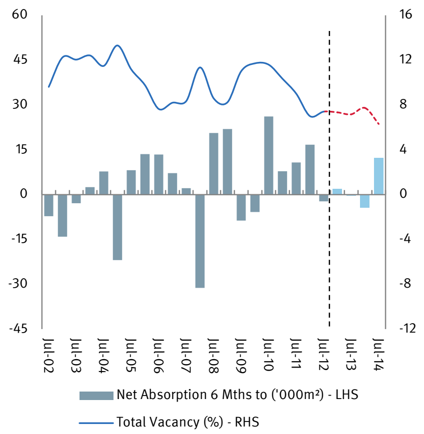
Figure 2
Total Vacant Stock
Prime and Secondary North Sydney ('000m²)



Source: PCA

Since the beginning of 2011, North Sydney has been the stand out performer in terms of rental growth, not only in the North Shore, but right across Sydney's office markets. While the majority of rental growth has stemmed from face rents, the last six months saw incentives start to give way due to the tight leasing metrics. In the six months to October 2012, prime net face rents increased 3.3% to an average of $606/m². Average prime incentives reduced from 25.0% to 22.5%, which underpinned a 7.6% increase in net effective rents over the same period.

Figure 3
Vacancy and Net Absorption
North Sydney – per six month period

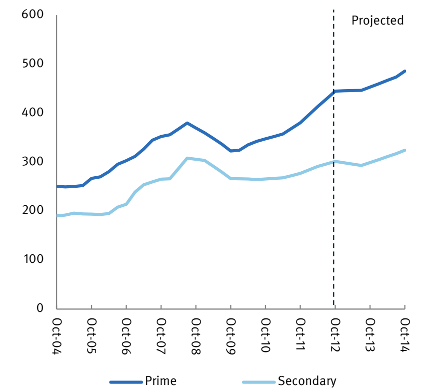


Source: PCA/Knight Frank

This outperformance of North Sydney rents has diminished its rental affordability compared with other markets (refer Figure 18, page 7). Coupled with the very limited leasing options and the dearth of new prime supply, some tenants are having to consider alternative markets when evaluating leasing options. TAL has already agreed to re-locate to the CBD, while some other tenants with pending lease expiries remain open to their options. This is expected to be a constraining factor in the rate at which North Sydney can generate further net absorption until asset upgrades or new supply can satisfy additional tenant requirements. These factors underpin a modest decline in the vacancy rate from the current level of 7.4% to 6.3% by July 2014, notwithstanding a brief uptick following the TAL exit. It is noted, however, that 80 Alfred Street, where TAL will vacate, is currently being marketed as a potential residential redevelopment site, subject to council approval. This scenario is not included in the forecast.

Some tenant outflow and the advent of forthcoming sub-lease space are expected to have a moderate upward impact on incentives over the next 12 months. Although partly offset by the absence of any major new supply, this is expected to see an easing in average rental growth over the next two years to between 3.5% and 4.0% per annum on a net face basis. The anticipated modest rise in incentives (circa 1% on average) over the 2013 financial year is forecast to unwind over financial years 2014 and 2015 as demand conditions gradually improve towards levels more commensurate with trend.

Figure 4
Net Effective Rents
Prime and Secondary North Sydney ($/m²)



Source: Knight Frank

Development Activity

While there is over 135,000m² of DA Approved buildings in the pipeline, relatively tight lending conditions mean significant developments continue to be delayed until a major pre-commitment is sourced. Despite the strong rental growth over the past two years, average market rents are only just starting to approach economic rents, which are broadly estimated at around $650/m² to $700/m² on a net face basis.

Recent stock additions have been made up of the 20 Berry Street refurbishment, where 761m² was completed at the end of 2011 with a further 2,642m² to be completed in the first quarter of 2013. In addition, 1,374m² at 157 Walker Street is also being refurbished and is expected to be completed by the end of 2012. The 39 residential apartment development Atria at 12 Berry Street by Besgate is due late 2013 and will incorporate a minor amount of commercial space of approximately 500m².

With regards to major new developments, however, it is unlikely that any of the four DA approved projects will complete until at least 2015. On balance, it appears that the more likely projects to proceed would be either 100 Mount Street (Laing O'Rourke, up to 40,000m²) or 77-81 Berry Street (Eastmark Holdings, 46,135m²).

Of the other projects, Winten have placed 177-199 Pacific Highway on the market, where the strata titled office complex has approval for a 38,000m² office complex. 80 Arthur Street remains a potential source of supply following the expiry of Meriton's option to buy with the site still DA Approved for 15,808m² of office space.

Sales and Investment Activity

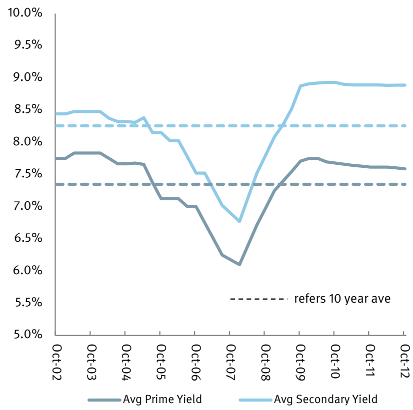
North Sydney sales activity has slowed somewhat over 2012 with activity mostly confined to B-grade assets. After recording sales transactions totalling $250.1 million in 2011 ($10 million+), total sales in 2012 amount to $75.2 million over two transactions. Most recently, 51 Berry Street was acquired by Property Bank Australia and Security Capital Corp for $15.6 million. The building was 100% occupied with the major tenant Ace Insurance, who accounted for 82% of passing income, recently committing to a 5 + 5 year lease to underpin a 4.6 year WALE. The sale was the second recent acquisition by the Perth based syndicate following the acquisition of 75 Miller Street for $22.25 million in 2011.

Property Bank Australia was also involved in the other 2012 sale, however this time with Rifici Group, when together they purchased 116 Miller Street and 173 Pacific Highway for $59.55 million. The upper B-grade asset sold with a 3.6 year WALE and a core market yield of 9.2%. Although settled in May 2012, the acquisition was agreed to in late 2011.

Current prime core market yields range between 7.25% and 8.00%, while for secondary assets the range is estimated at 8.75% to 9.25%. While the 9.8% core market yield recorded for 51 Berry Street appeared relatively soft compared to this range, it is noted that the initial yield was 8.8% with the rental reversion of the under rented office component of the asset not reverting until 2017.

The yield spread between prime and secondary assets remains elevated at 130bps or almost 40bps above the 10 year average. Tighter leasing conditions for prime grade stock in conjunction with debt finance still favouring prime assets is expected to see this spread remain over the next two years. This is set to sustain opportunities for investors to acquire secondary assets on relatively favourable metrics with the prospect of repositioning and leasing into the tighter A-grade market.

Figure 5
Average Core Market Yields
North Sydney



Source: Knight Frank

Table 2
Recent Leasing Activity North Sydney

Address	Region	Area (m²)	Face Rental ($/m²)	Term (yrs)	Lease Type	Tenant	Start Date
100 Pacific Highway	North Sydney	1,944	627n	7	Renewal	Logica	Feb-13
201 Miller Street	North Sydney	277	500n	5	New	BMS Sales Recruitment	Sep-12
100 Pacific Highway	North Sydney	1,198	Conf	7	New	Tibco	Aug-12
99 Mount Street	North Sydney	228	450g	3	New	Allocate Software	Jul-12
75 Miller Street	North Sydney	170	552g	5	New	ProLegis	Jul-12
75 Miller Street	North Sydney	180	540g	5	New	Risk Advisory Services	May-12
168 Walker Street	North Sydney	7,800	450g	5	Renewal	First Data	Apr-12
51 Berry Street	North Sydney	3,541	400n	5	Renewal	ACE	Mar-12

Table 3
Recent Sales Activity North Sydney

Address	Price ($ mil)	Core Market Yield (%)	NLA (m²)	$/m² NLA	WALE (Years)	Vendor	Purchaser	Sale Date
51 Berry Street	15.60	9.80*	3,541	4,406	4.6	Berry 51 Pty Ltd	Property Bank Australia & Security Capital Corp	Apr-12
116 Miller Street & 173 Pacific Hwy	59.55	9.20	11,352	5,245	3.6	AMP Capital Investors Limited	Rifici Group & Property Bank Australia	Mar-12

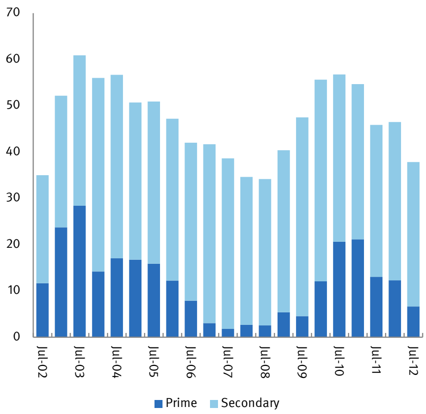
Source: Knight Frank n refers net g refers gross * initial yield of 8.8%

CROWS NEST/ST LEONARDS

Leasing Market and Rents

Crows Nest/St Leonards performed strongly in the first half of 2012 with the vacancy rate falling from 13.0% to 10.7%. On the demand side, 4,638m² of positive net absorption was recorded with the result boosted by Cardno's occupation of 4,000m² at 203 Pacific Highway (after agreeing in 2011 to re-locate from Gordon). The move had a particularly strong impact on the A-grade vacancy rate, which fell sharply from 13.9% to 7.5%. Only 6,643m² of A-grade stock remains vacant following a significant decline since the beginning of 2011 (refer Figure 6).

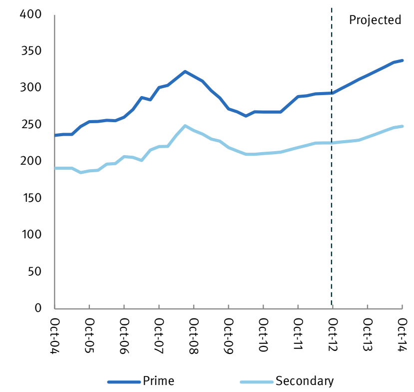
Figure 6
Total Vacant Stock
Prime and Secondary Crows Nest/St Leonards ('000m²)



Source: PCA

In response to tightening prime leasing conditions, rents have continued to post positive growth, albeit at a softer rate compared to that recorded in late 2011/early 2012. Prime net face rents average $466/m², representing annual growth to October 2012 of 1.9%. Although leasing demand continues to favour prime buildings, secondary rental growth on an annual basis surprisingly outperformed prime. As at October, secondary net face rents averaged $379/m², representing annual growth of 3.1%. It is considered that this result reflects some 'catch up' after the strong growth in prime rents from mid 2009 to late 2011 rather than any material shift in tenant demand. No change in incentives was recorded in the last 12 months, with incentives (measured on a gross basis) holding steady at 30% and 32% for prime and secondary respectively.

Figure 7
Net Effective Rents
Prime & Secondary Crows Nest/St Leonards ($/m²)



Source: Knight Frank

Despite the moderation in prime rental growth and some recent softness in labour market indices, robust growth in prime rents is projected for the next two years. This is forecast to largely stem from tighter prime leasing conditions, as well as some flow on benefit from the strong rental growth in North Sydney. The lack of leasing options in North Sydney will also support demand for Crows Nest/St Leonards as some tenants look at viable alternative locations. Rental growth is expected to predominantly come through in face rental growth, with incentives unlikely to show a material easing until FY 2014. Over the next two years, prime face rental growth is forecast to average 4.0% p.a, while on an effective basis, the moderation in incentives will underpin average annual growth of 5.8%p.a. In the secondary market, rental growth is expected to lag the growth projected for prime in view of 82% of vacant stock being classified as secondary stock. Over the next two years, secondary face rental growth is forecast to average 2.5%, while on an effective basis an average growth rate of 4.0% is projected.

Development Activity

The forthcoming completion of Building C at Lindsay Bennelong's Gore Hill development is set to provide the market with its first new supply since the second half of 2005 (note the ASX Data Centre is not classified as office). The building will provide 14,136m² of new stock with 48% pre-leased to Fox Sports. A formal leasing agreement has yet to be attained for the residual space. Fox Sports have expansion rights over this space, however in the event that these rights are not exercised, it is unlikely that a leasing deal will be finalised before completion. This assumption forms the basis of the vacancy forecast in Figure 8 and underpins an uptick in the vacancy rate to 12.2% for January 2013.

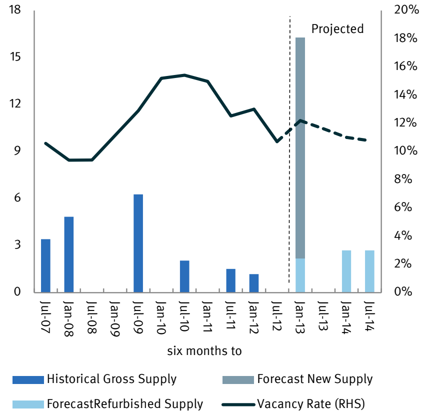
However the progression of the remaining proposed buildings at Gore Hill remains reliant on pre-commitments, which suggests further building completions are unlikely until at least 2015. Thus there will be a three year interval in new supply (excluding smaller refurbishments) that will allow the vacancy rate to gradually decline to a forecast level of 9.3% by mid 2015. The steady decline in vacancies will be further enhanced by some forthcoming withdrawals, which will undergo a change of use to residential. These include 619 Pacific Highway (2,206m²) and 51 Chandos Street (1,200m²), which are both set to undergo development within the next year.

While the DA Approved site at 88 Christie Street remains in the supply pipeline, timing remains uncertain following Winten Property Group (as owner) offering the property to market for sale. The existing DA provides for an 18 storey commercial tower (with ancillary retail) of approximately 28,500m². However the lead times involved in attaining pre-commitments and construction suggest that completion is unlikely until at least late 2016.

Figure 8

Annual Gross Supply vs Vacancy Rate

Crows Nest/St Leonards ('000m² LHS and % RHS)



Source: PCA/Knight Frank

Sales and Investment Activity

Akin to other Sydney markets, some of the sales momentum generated at the end of 2011 has slowed in 2012 with only one sale recorded to date in 2012 in excess of $5 million. This was the sale of 154 Pacific Highway by Charter Hall Direct Property Fund to Perth based investors Property Bank Australia. The 6,427m² property sold for $25.5 million on a core market yield of 10.2%.

The yield reflected the 37.8% vacancy at the date of sale and the subsequent 2.0 year WALE. The property was originally occupied by Johnson & Johnson, but now houses Ramsay Health Care who are the major tenant occupying 41% of the property.

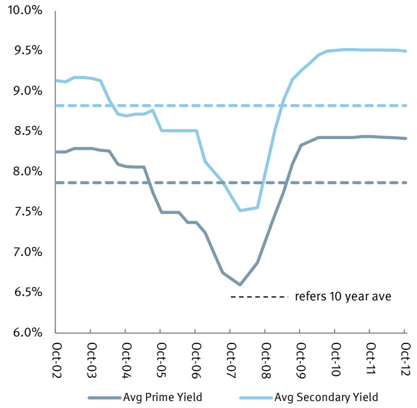
While transacting in late 2011, the sales by Lindsay Bennelong Developments at the end of 2011 remain key benchmarks for the Crows Nest/St Leonards market. Building C which is due for completion in late 2012, sold to Growthpoint Properties Australia for $82.70 million. While only half committed to Fox Sports, the sale included a five year rental guarantee on the vacant component resulting in a WALE of 7.4 years. The asset transacted on a core market yield of 8.10%, a level consistent with the average prime range for the Crows Nest/St Leonards area of between 8.00% and 8.75%. The other sale was Building B1 (albeit a data centre rather than a traditional office building), which sold for $60 million. The property was sold with a 15 year lease to the Australian Stock Exchange and achieved a core market yield of 7.60% demonstrating the strength in demand for assets with a long term secure income stream.

For secondary assets, average core market yields are estimated to range between 9.00% and 9.75%. This level represents a circa 200 basis point increase from the peak in the market of early 2008 compared to a decompression in prime yields of circa 180 basis points. The resultant spread between prime and secondary yields of 108 basis points is now above the ten year average of 95 basis points.

Figure 9

Average Core Market Yields

Crows Nest/St Leonards



Source: Knight Frank

Table 4

Recent Leasing Activity Crows Nest/St Leonards

Address	Region	Area (m²)	Face Rental ($/m²)	Term (yrs)	Lease Type	Tenant	Start Date
Bldg C, 219-247 Pacific Highway	Artarmon	5,924	430n	10	Pre lease	Fox Sports	Dec-12
29 Christie Street	St Leonards	465	Conf	7	Expansion	Toyota Financial Services	Sep-12
52 Chandos Street	St Leonards	220	350g	5	New	Commodity Inspection Services	Aug-12
39 Chandos Street	St Leonards	340	385n	5	New	VDM	Mar-12

Table 5

Recent Sales Activity Crows Nest/St Leonards

Address	Price ($ mil)	Core Market Yield (%)	NLA (m²)	$/m² NLA	WALE (Years)	Vendor	Purchaser	Sale Date
154 Pacific Highway	25.50	10.20	6,427	3,968	2.0	Charter Hall Direct Property Fund	Property Bank Australia & Security Capital Corp	May-12
51 Chandos Street‡	4.70	N/A	1,200	3,917	N/A	Talish P/L	Best magic Ventures P/L	Apr-12
Bldg C, Gore Hill Business Park 219-247 Pacific Highway	82.70	8.10	14,136	5,850	7.4	Lindsay Bennelong Developments	Growthpoint Properties Australia Ltd	Dec-11
Bldg B1, Gore Hill Business Park 219-247 Pacific Highway^	60.00	7.60	11,463	5,234	12.0*	Lindsay Bennelong Developments	Securus Guernsey 2 Ltd	Dec-11

Source: Knight Frank n refers net g refers gross Conf refers confidential ‡ purchased for residential conversion
^ data centre * reflects break clause at end of year 12 of 15 year term

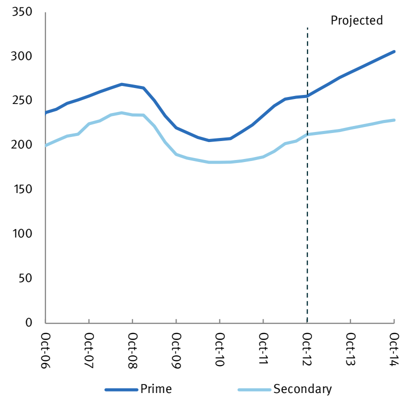
CHATSWOOD

Leasing Market and Rents

Demand for Chatswood office space showed encouraging growth in the first half of 2012 with 4,326m² of positive net absorption being recorded in the six months to July. This was the highest half yearly result since 2008. Key to the leasing momentum in Chatswood has been the successful re-lease of FKP's refurbishment at 465 Victoria Avenue, where leases have been executed over all 15 levels of the 14,428m² building. While in the July PCA data the refurbished space was recorded as new supply, the leasing deals were not fully reflected. This resulted in the vacancy rate increasing from 10.6% to 13.7%.

However the next six months is forecast to see the vacancy rate come back down sharply to a projected 10.0% given all forthcoming tenants into 465 Victoria Avenue will add directly to net absorption. Of the incoming tenants, Tech Mahindra (983m²) are relocating from North Sydney, Real Insurance (4,915m²) are relocating from Norwest and Lend Lease (2,949m²) are a new lease in the Chatswood market. Beyond that, the vacancy rate is forecast to gradually ease to 8.7% by July 2014. The vacancy rate has not reached a level this low since 2007. However with only 11,739m² of combined vacant prime stock as at July in North Sydney and Crows Nest/St Leonards, net absorption is expected to remain positive, benefitting from the lack of alternatives in competing markets.

Figure 10
Net Effective Rents
Chatswood ($/m²)



Source: Knight Frank

Annual rental growth remains strong, however the majority of the growth was generated over the end of 2011 and first quarter of 2012, with the growth rate having eased over the past six months. Prime net face rents posted annual growth of 3.4% to $410/m², with incentives averaging 30% (on a gross basis). Prime face rental growth is forecast to average 4.0% over the next two years, which is anticipated to be supplemented by a slight reduction in average incentive levels. Secondary net face rents average $356/m² with incentives approximately two percentage points higher than prime at 32.0%.

Development Activity

Over the past 15 years, development activity in Chatswood has broadly consisted of withdrawn space undergoing refurbishment before being returned to the market six to twelve months later. This was the case in the six months to July, where the refurbished supply of the 14,428m² at 465 Victoria Avenue effectively reversed the large withdrawal at the end of 2011. This lack of new development has seen stock levels remain broadly flat for over a decade with the current stock level of 280,845m² actually less than the market peak of 293,056m² recorded in 1997.

Although the Thomas Street Car Park site in Albert Avenue has DA Approval for a commercial office development, the site's subsequent sale to Meriton (and likely change of use to residential) suggests that the only forthcoming office supply will stem from the office component of Mirvac's ERA residential development. The 295 apartment development includes 4,900m² of office space due for completion in early 2014.

Table 6
Recent Leasing Activity Chatswood

Address	Region	Area (m²)	Face Rental ($/m²)	Term (yrs)	Lease Type	Tenant	Start Date
465 Victoria Avenue	Chatswood	4,915	437n~	8	New	Real Insurance	Dec-12
9 Help Street	Chatswood	315	370n	3	New	Genband	Nov-12
799 Pacific Highway	Chatswood	893	400n	5	New	Kymon	Sep-12
465 Victoria Avenue	Chatswood	2,949	463n~	5	New	Lend Lease	Aug-12*
465 Victoria Avenue	Chatswood	983	405n	5	New	Tech Mahindra	Jul-12
67 Albert Avenue	Chatswood	1,098	390n	5	New	Health	U/D

Table 7
Recent Sales Activity Chatswood

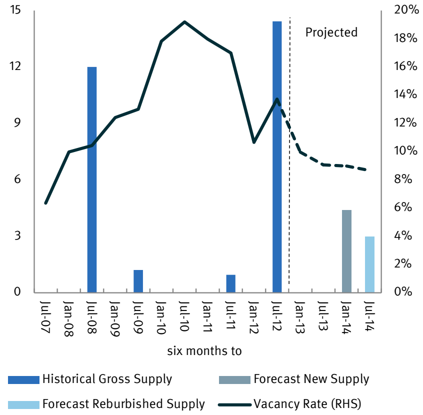
Address	Price ($ mil)	Core Market Yield (%)	NLA (m²)	$/m² NLA	WALE (Years)	Vendor	Purchaser	Sale Date
10 Help Street, Chatswood	23.0	U/D	7,290	3,155	U/D	Oakland Property Holdings	Private Investor	Apr-12

Source: Knight Frank   n refers net   ~ average rate of floors leased   * 983m² of lease commences December 2012   U/D refers undisclosed

Figure 11

Annual Gross Supply vs Vacancy Rate

Chatswood ('000m² LHS and % RHS)



Source: PCA/Knight Frank

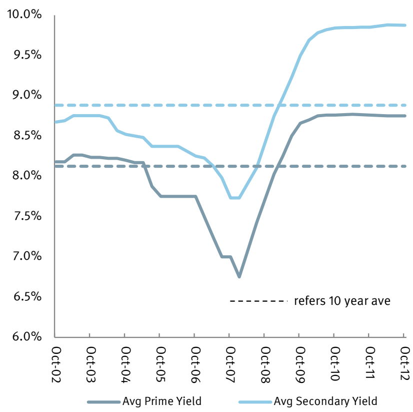
Sales and Investment Activity

The sale of 10 Help Street in April marked the first major commercial transaction in Chatswood since FKP's purchase of Vero Tower back in 2007. Although the asset sold for $23 million, it is understood that the vendor was under some pressure to dispose of the asset. It is estimated that average core market yields currently range from 8.50% to 9.25% for prime and 9.50% to 10.25% for secondary. The current offerings of The Zenith and 465 Victoria Avenue will serve as key indicators for prime assets in the market.

Figure 12

Average Core Market Yields

Chatswood



Source: Knight Frank

MACQUARIE PARK/ NORTH RYDE

Leasing Market and Rents

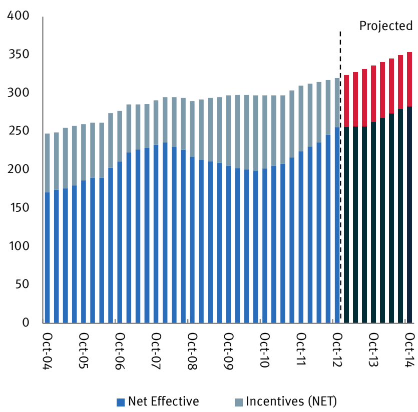
The robust tenant demand across North Ryde/Macquarie Park that has driven a steady decline in the vacancy rate since 2010 continued over the first half of 2012. During the six months to July, 21,293m² of positive net absorption was recorded. While around half of this was underpinned by the Department of Innovation, Industry, Science and Research moving from Pymble into 10,270m² of pre-committed supply, the remaining absorption consisted of leases into existing buildings. Major new leases included Mine Site Technologies (2,062m²) moving into their new global headquarters, Hamlon (1,170m² office space) relocating from Frenchs Forest and Avnet (1,012m²) consolidating from their tenancies at Gladesville and 2 Giffnock Avenue, North Ryde. The result of this demand has been a drop in the vacancy rate from 8.2% as at January to 6.7%. In the prime market, where demand has almost exclusively been concentrated, the vacancy rate now measures 4.0%, which is the tightest level since the series began in 2005.

The firm tenant demand has fed through into rental rates, with prime net face rents averaging $320/m². While this reflects an annual growth rate of 3.2%, the reduction in incentives (on a net basis) from 27.5% 12 months ago to 20% currently has driven a particularly strong 13.9% annual growth rate on a net effective basis. Despite demand for secondary stock being outpaced by prime, the lack of options has also seen commensurate face rental growth extend to the secondary market. Secondary net face rents now average $283/m², however incentives have held steady at an average of 30.0% on a net basis.

Figure 13

A-Grade Net Rents and Incentives

North Ryde/Macquarie Park ($/m²)



Source: Knight Frank

Table 8

Recent Leasing Activity North Ryde/Macquarie Park

Address	Area (m²)	Face Rental ($/m²)	Term (yrs)	Lease Type	Tenant	Start Date
82 Waterloo Road	1,500	Conf	5	Renewal	McGraw Hill	Jul-12
140 Wicks Road	1,078	220n	4	New	NBI	Jun-12
113 Wicks Road	1,435*	245n	7	New	Mine Site Technologies	May-12
68 Waterloo Road	1,170*	285n	7	New	Hamlon	Mar-12
67 Epping Road	993	310n	5	New	Imagetec	Mar-12
7 Eden Park Drive	547	315n	4	New	Kronos	Mar-12
123 Epping Road	1,322	315n	5	New	Shire	Jan-12

Source: Knight Frank Conf refers confidential n refers net * office component

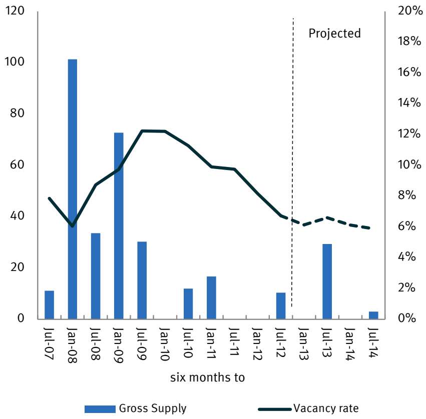
Development Activity

Despite the positive results recorded in tenant demand and the tightening leasing conditions for A Grade space, no speculative development is likely to occur across Macquarie Park/North Ryde. Two projects are currently under construction, consisting of the Macquarie University's Australian Hearing Hub and Goodman's development of 22 Giffnock Avenue. The former will provide a six storey, 19,538m² commercial office building, which is 74% committed to Macquarie University and hearing related organisations. The project is due to come online in the first quarter of 2013. The development of 22 Giffnock Avenue is 100% pre-leased to Optus and is situated adjacent to their headquarters on Lyon Park Road. The seven storey commercial building of 9,786m² is due for completion in the second quarter of 2013.

With the combined pre-commitment of these two projects measuring 82.4%, the impact on the vacancy rate is anticipated to be minimal. From the current vacancy rate of 6.7%, the vacancy rate is forecast to moderate closer to 6.1% by the end of the year, before rising to a level of 6.6% by mid 2013. While there are six projects with DA approval in the supply pipeline they are unlikely to proceed until pre commitment is secured, which means further supply is unlikely until at least late 2014. This is forecast to allow the vacancy rate to steadily trend back to around 6.0% by the end of FY2014.

Of the sites with DA Approval, the DEXUS site at 112 Talavera Road (12,000m²) is currently being actively marketed. Other potential DA Approved sites that could be progressed include Goodman at 27-37 Delhi Road (32,000m² over four buildings), Stockland at 39 Delhi Road (30,000m²) and Pathway Property at 1 Rivett Road (11,822m²). At 80 Waterloo Road, Centuria Funds Management have withdrawn their DA Application, while DEXUS have placed 144 Wicks Road on the market with Stage One Masterplan Approval.

Figure 14
Annual Gross Supply vs Vacancy Rate
North Ryde/Macquarie Park ('000m² LHS & % RHS)



Source: Knight Frank/PCA

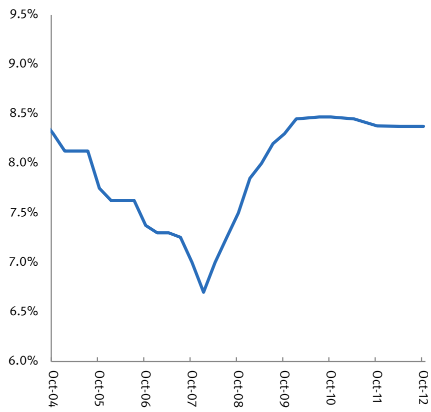
Sales and Investment Activity

The June 2012 sale of 12 Waterloo Road for $9.1 million marked the second significant transaction for North Ryde/Macquarie Park in 2012. The four level office building with a 3,947m² NLA was sold by Investa Funds Management to a consortium of private investors, Centennial Property Group. While Knight Frank estimates that average secondary market core yields range between 9.0% and 10.0%, it is noted that this is based on a 5.0 year WALE. 12 Waterloo Road traded at 10.8%, reflective of the 9.0% vacancy in the building and the 1.7 year WALE.

The other 2012 sale was back in April, when 75 Talavera Road was transacted for $40.5 million. The sale marked the first major commercial office investment transaction to occur in the area since 78 Waterloo Road sold for $67.0 million in 2007. Sold by Challenger Diversified Property Trust (60%) and Challenger Life Company (40%), the leasehold of the property was sold to Macquarie University in an off-market transaction. The sale equated to a core market yield of 8.80%, which reflected the 72% occupancy and 4.3 year WALE.

The average yield for Macquarie Park/North Ryde has remained relatively constant over the past three years. The average core market yield for prime assets is estimated to range between 8.00% and 8.75%.

Figure 15
Average A-Grade Core Market Yields
North Ryde/Macquarie Park



Source: Knight Frank

Table 9
Recent Sales Activity North Ryde/Macquarie Park

Address	Price ($ mil)	Core Market Yield (%)	NLA (m²)	$/m² NLA	WALE (Years)	Vendor	Purchaser	Sale Date
12 Waterloo Road, Macquarie Park	9.10	10.80	3,947	2,306	1.7	Investa Funds Management	Centennial Property Group	Jun-12
75 Talavera Road, Macquarie Park*	40.50	8.80	13,429	3,016	4.3	Challenger Diversified Property Group	Macquarie University	Apr-12

Source: Knight Frank n refers net * leasehold

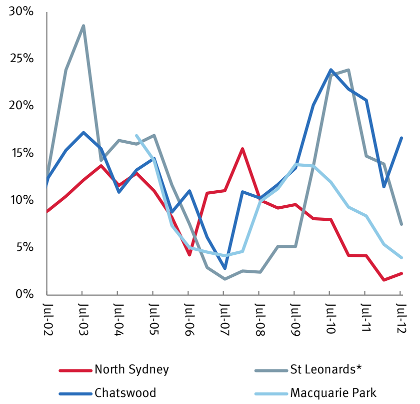
OUTLOOK

Despite some anticipated moderation in employment growth, relatively tight prime leasing conditions and a shortage of forthcoming supply will continue to support the North Shore office markets. With the exception of the recent uptick in Chatswood, all markets have seen sharp falls in prime vacancy rates over the past two years (refer Figure 16), although in the case of Chatswood, the recent uptick will be reversed with 465 Victoria Avenue now fully committed.

Figure 16

Prime Vacancy Rates

By region (%)



* includes Crows Nest and Gore Hill

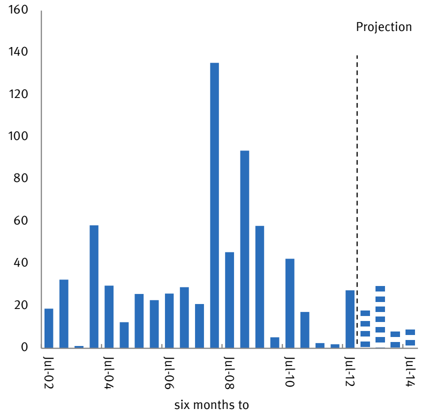
Source: PCA

As per Figure 17, supply in the North Shore and North Ryde markets over the next two years will predominantly come online in the next 12 months. However 89% of supply in FY 2013 is driven by three projects (Gore Hill in St Leonards and The Australian Hearing Hub and 22 Giffnock Avenue in North Ryde), which have a combined pre-commitment of 71%. Given these pre-commitments will add directly to net absorption without any subsequent backfill, the supply impact on vacancy is anticipated to be minimal. As a result the vacancy rates across the North Shore markets are forecast to trend gently downwards, with the exception of several relatively small blips as discussed in the preceding sections.

Figure 17

North Shore & North Ryde Forecast Gross Supply

Per six month period ('000m²)



Source: PCA/Knight Frank

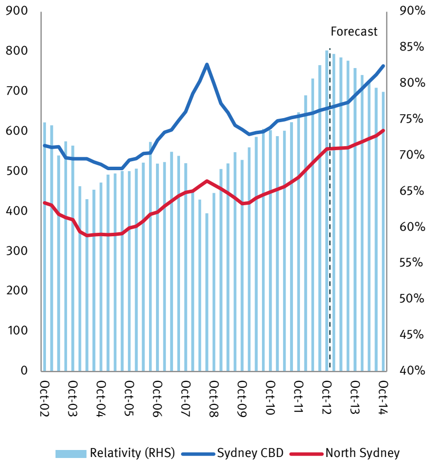
Despite the base case forecast for white collar employment growth over the coming two years being below trend, persistently tight vacancy rates are expected to underpin a continuation of the rental growth albeit at a lesser rate. Prime net face rents amongst the North Shore markets are all forecast to record growth slightly above CPI over the next two years, with the average growth ranging from 3.75% to 4.5% p.a amongst the various markets. The outlook for incentives is slightly more varied. In North Sydney, pending sub-lease space is likely to see relative stability in incentive levels. However in North Ryde, the market is benefitting from its ability to more readily provide relatively affordable, full floor prime leasing options compared to competing markets such as Homebush and Parramatta. This is anticipated to remain supportive of demand and underpin some subsequent moderation in incentive levels.

Rental affordability is also set to impact the pattern of tenant flow around North Sydney. Back in mid 2008, North Sydney rents, on a prime gross effective basis, equated to 62% of the average rate in the CBD. However, subsequently, as per Figure 18, this relativity has closed significantly with the ratio increasing to 85%. The impact is expected to see North Sydney tenants considering the CBD's Western Corridor and Midtown precincts given the strong rental growth in North Sydney and the high incentives on offer in the CBD.

Figure 18

Prime Gross Effective Rents and Relativity

Sydney CBD vs North Sydney ($/m²)



Source: Knight Frank

Despite tight leasing metrics and the significant spread available between yields at near cyclical highs and real bond rates, transaction activity is expected to remain steady as buyers continue to be very selective in investment decisions. The concentration of transactions in upper B-grade assets is likely to continue. This is expected to be driven by tier one funds looking to reduce holdings in this asset grade and selling to wealthy privates and syndicates with access to capital and an appetite for favourable yields. Buyers prepared to add value through refurbishment will stand to benefit from the lack of prime leasing options currently available.

Buyer depth for prime assets remains more limited with access to capital still a constraint for some buyers. However, the narrowing gap between trading prices and NTA will start to support AREITs looking at acquisitions. Normally the robust outlook for rental growth and the large spread between bonds and property yields would imply a tightening bias for yields, however this could be constrained somewhat until capital becomes more readily accessible. Prime offerings in the market such as Space 207 in St Leonards and The Zenith in Chatswood will be key indicators for prime valuations in the North Shore.

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Knight Frank Newmark Global

Knight Frank Research

Nick Hoskins
Associate Director – NSW Research
+61 2 9036 6766
Nick.hoskins@au.knightfrank.com

Matt Whitby
National Director
Head of Research & Consulting Services
+61 2 9036 6616
Matt.whitby@au.knightfrank.com

Knight Frank Valuations

David Castles
State Director, Knight Frank Valuations
+61 2 9036 6648
David.castles@au.knightfrank.com

Tom Phelan
Divisional Director, North Sydney
+61 2 9028 1131
Tom.phelan@au.knightfrank.com

Lachlan Graham
Divisional Director, North Sydney
+61 2 9028 1132
Lachlan.graham@au.knightfrank.com

Commercial Agency Contacts

Kymbal Dunne
Managing Director – North Sydney
+61 2 9028 1100
Kymbal.dunne @au.knightfrank.com

Giuseppe Ruberto
Director – Office Leasing, North Shore
+61 2 9028 1115
Giuseppe.ruberto@au.knightfrank.com

Brett Burridge
Director, Commercial Sales & Investments
+61 2 9028 1139
Brett.burridge@au.knightfrank.com

James Parry
National Director
Head of Capital Transactions, NSW
+61 2 9036 6758
James.parry@au.knightfrank.com

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

Richard Garland
Director, Commercial Sales & Investments
+61 2 9036 6744
Richard.garland@au.knightfrank.com

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