1

*Strong demographic drivers in CBD fringe*

2

*Under-supply of prime stock*

3

*Rental growth outperforming*

# Sydney City Fringe

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## Office Insight, August 2022

# EXPANSION OF CBD TO FRINGE AND SOUTHERN BOUNDARIES

**40%**
Net effective rental growth in Surry Hills over last five years

**35%**
Of average take up in fringe markets from tech occupiers

**3.7%**
Prime grade vacancy across fringe markets as at Jul-22

**"The evolution of Greater Sydney and growth of knowledge-intensive industries will help elevate the status of the CBD's Southern fringe areas to a thriving economic, amenity-rich commercial office destination."**

## The Key Insights

Sydney's fringe office markets continue to expand, linked closely to the growth of the tech sector which accounts for 35% of deal activity on average each year, in contrast with 18% in the CBD.

Despite strong occupier demand, there is a lack of prime grade space across majority of the fringe markets, particularly in Surry Hills and Eveleigh, with sub 2% availability.

Prime grade space accounts for under 30% of the stock base across the fringe markets, in comparison to the CBD averaging 63%

Over the last five years net effective rental growth across the major fringe markets has more than doubled the pace in the CBD, in particular Pyrmont and Surry Hills which have grown by 57% and 40% respectively.

On a net face basis, the rental discount spread ranges between 40-50% between the various fringe markets and the Sydney CBD, highlighting further long-term growth potential.

Central Precinct is earmarked for up to 250,000sqm of commercial space with the aim to house start ups, scale ups and innovation ecosystem partners, which is forecast to create 25,000 jobs by 2036.

### City Fringe Office Market Indicators—July 2022

| MARKET | TOTAL STOCK SQM | TOTAL VACANCY RATE % | PRIME VACANCY RATE % | AVERAGE PRIME NET FACE RENT RANGE $/SQM | INCENTIVE %^ | CORE MARKET YIELD %* |
|---|---|---|---|---|---|---|
| Surry Hills | 474,957 | 5.6 | 1.4 | 650-850 | 25-35 | 4.50-5.25 |
| Pyrmont | 307,273 | 6.8 | 4.8 | 650-850 | 25-35 | 4.75-5.50 |
| Eveleigh | 195,118 | 1.1 | 1.2 | 650-850 | 25-35 | 4.75-5.50 |
| Ultimo | 130,716 | 7.2 | 8.0 | 550-750 | 25-35 | 4.75-5.75 |
| Redfern | 111,474 | 7.8 | 6.2 | 550-750 | 25-35 | 4.75-5.75 |
| Darlinghurst | 60,772 | 7.0 | 12.2 | 600-800 | 25-35 | 4.75-5.50 |
| Chippendale | 51,423 | 5.3 | 4.1 | 600-800 | 25-35 | 4.75-5.50 |
| Total | 1,331,733 | 5.6 | 3.7 | | | |

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

# FRINGE DRIVES ECONOMIC REBOUND IN SYDNEY

### Robust recovery Sydney to drive rapid growth in the CBD fringe

Australia's economy has been a leading performer among the major advanced economies for many years, demonstrating strong and sustained growth over the past three decades. Like all economies, Australia has been buffeted by restrictions on movement and economic activity put in place to mitigate the health risks of the pandemic, but the economy has shown its resilience and ability to rebound quickly. Output and employment are rebounding strongly, supported by robust consumer spending, and rapid growth is expected in 2022, led by a strong recovery in Sydney.

Sydney's CBD and inner fringe have enjoyed particularly strong economic growth in recent decades. Gross regional product in the City of Sydney local government area (including the CBD and surrounding suburbs such as Darlinghurst, Surry Hills, Prymont, Ultimo, Chippendale, and Redfern) totalled $131.2 billion in 2021 and has more than doubled over the past two decades (growing at an average rate of 3.7% per annum). Economic growth in inner Sydney has significantly outpaced that of Greater Sydney, which has grown by 62.4% (or 2.5% per annum) over the same period. Reflecting this stronger growth, the City of Sydney's share of total Greater Sydney output rose from 21.5% in 2001 to 27.4% in 2021.

### Easing border restrictions to facilitate the resumption of strong population growth

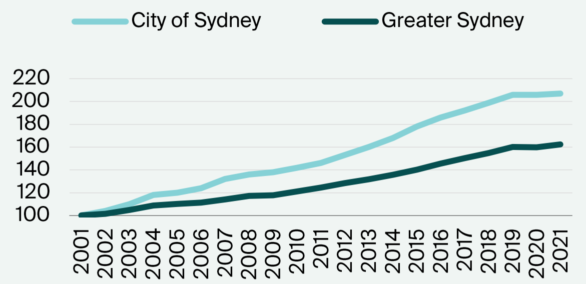
The high long-term growth rate of Australia and its major cities can be partly attributed to strong population growth, which has underpinned a sustained rise in employment and economic output. Over the past 20 years, Australia's population has grown by 34%, well in excess of the growth experienced by other major economies including the US (17%), UK (14%), Germany (2%) and Japan (-1%).

Strong population growth has led to the rapid expansion of major cities led by Sydney and Melbourne, which have seen significantly faster economic and employment growth than other Australian cities. Sydney's CBD and inner fringe have enjoyed particularly strong population growth (66.0%) over the past two decades compared with 30.7% growth rate for Greater Sydney, with most inner city suburbs recording significantly stronger population growth than the Sydney average despite the disruption to global migration resulting from the pandemic. With pandemic border now restrictions easing, these longer-term population growth trends are set to reassert themselves, with particular benefits for the CBD and inner fringe areas of Sydney and Australia's other major capital cities.

### More highly skilled and service-orientated economy to drive demand for office space

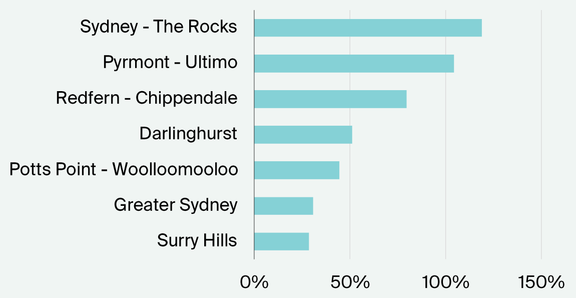
In line with national trends, Sydney's economy has become more weighted towards skilled services industries. Financial services accounted for 16.4% of gross value added (GVA) in 2021, compared with 13.3% in 2001, while professional services' share rose from 9.9% to 12.9% over the same period. By contrast, the share of manufacturing output has declined significantly. Along with sustained long-term population growth, the relatively strong growth of highly skilled service industries will facilitate white-collar employment growth and demand for office space.

Gross regional product
Index, 2001 = 100




Source: Knight Frank research,ABS

Population growth, 2001-2021
Per cent




Source: Knight Frank Research, ABS

# FAVOURABLE DEMOGRAPHICS IN THE FRINGE

## Young and highly skilled workforce drive city fringe expansion

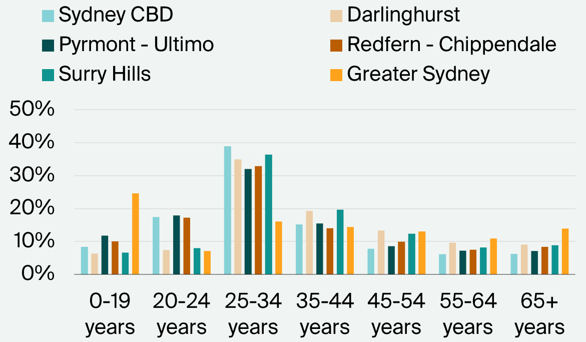
Inner city Sydney has a relatively young adult population. Over 46% of Sydney's CBD and city fringe population were between 20 and 34 years of age as at the 2016 Census, more than double the 23% share for Greater Sydney. The CBD, Pyrmont-Ultimo, and Redfern-Chippendale have a particularly high share of people within this age cohort, ranging between 50% and 56%.

Surry Hills and Darlinghurst have relatively higher shares of 25-34-year-olds at 36% and 35% respectively, while 20-24-year -olds are more concentrated in Pyrmont-Ultimo (18%) and Redfern-Chippendale (17%).

Sydney's inner-city population is relatively highly educated. Around half of the resident population of the Sydney CBD and city fringe hold a bachelor's degree compared to 36% for Greater Sydney. Rates of tertiary educational attainment are evenly spread across the city fringe suburbs with between 50% and 51% of the population of Darlinghurst, Pyrmont-Ultimo, Redfern-Chippendale, and Surry Hills holding a bachelor's degree. Similarly, around one-fifth of inner-city Sydney residents hold postgraduate qualifications compared with 14% for Greater Sydney.

### Age distribution

Proportion of resident population by age



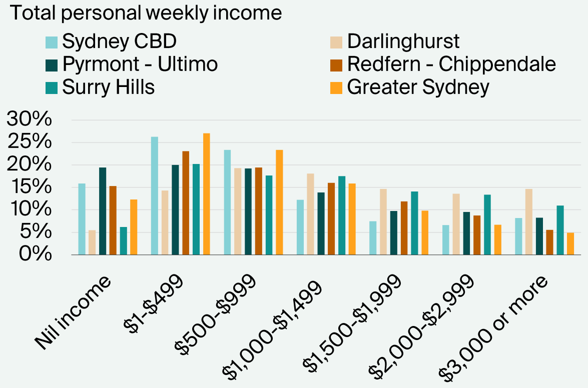

Source: Knight Frank Research, ABS

## High income earning population highlight the fringe's appeal as an area to live and work

Reflecting the relatively highly skilled and educated population as well as the area's enduring appeal, Sydney's city fringe suburbs have a larger proportion of high-income earners compared to the Greater Sydney average. This is particularly true in Darlinghurst and Surry Hills where 28% and 24% of residents respectively have a total weekly income of $2,000 or more, more than double the 12% average for Greater Sydney. Pyrmont-Ultimo and Redfern-Chippendale also have a greater than average share of high-income earners but less than Darlinghurst and Surry Hills at 18% and 14% respectively.

### Income distribution

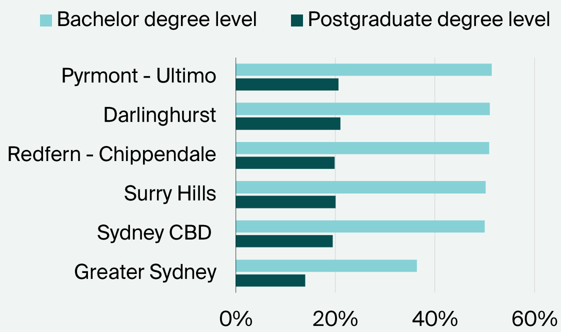
Total personal weekly income




Source: Knight Frank Research, ABS

### Educational attainment

Proportion of resident population holding degree




Source: Knight Frank Research, ABS

# DEMAND LED TRANSFORMATION

### Tech, creative and education industries drive demand

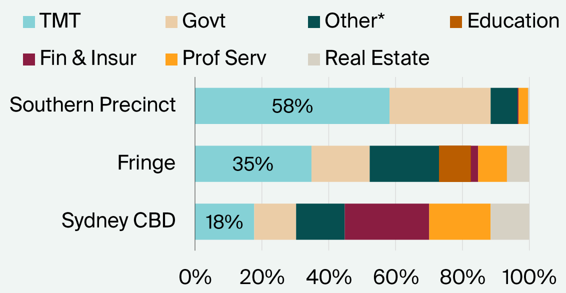
Businesses in the technology sector and wider creative industries have been at the forefront of the fringe markets rapid expansion and revitalisation as an office market of choice. The favourable demographic profile offers ready access to talent, and the appeal of co-locating alongside likeminded businesses in close proximity to major universities are compelling for many occupiers. In addition, fringe workspaces offers a distinct point of difference to the traditional CBD and this appeals to many tenants looking to use their real estate strategy to help position their brand and appeal to potential new hires. With rich amenity on the doorstep, the requisite ingredients are in place for creative businesses to cluster and thrive.

The solid foundations and attraction in the city fringe for these occupiers has been evident in take-up levels over the last five years, with tech occupiers accounting for an average 35% of deal activity each year, much higher than in the CBD (18% on average). Examples of new entrants include Quantium Data securing 12,369sqm as its new HQ in Mirvac's refurbished Locomotive workshop last year and SpeeDx, a molecular diagnostics company leasing 3,000sqm at 8 Central Avenue in South Eveleigh. Late last year, Afterpay; one of Australia's largest Fintech companies pre-committed to 3,700sqm at IP Generations Brewery Central Park development.

As the fringe markets develop and mature, we are now seeing the markets evolve organically to accommodate specific business clusters, and over time this will segment the markets more clearly.

**Lease deals by industry sector**

5 year average by market




Source: Knight Frank Research

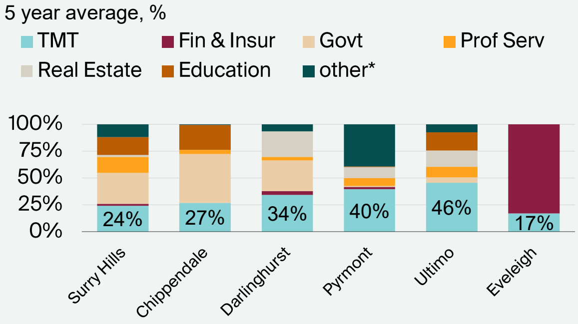
For example, Ultimo and Chippendale have a high proportion of education and high-tech occupiers accounting for 63% and 50% respectively of average take-up, while Pyrmont hosts an established digital cluster centred around larger occupiers. Surry Hills is a larger market with a more diverse tenant mix that is less oriented around technology, while the larger scale of recent development in Eveleigh has facilitated ed major commitments from FinTech and data science.

### Vacancy tracks below major markets

Rising demand from occupiers and limited new supply over the past decade has led to overall vacancy in all the major fringe markets tracking well below the Sydney CBD and major metro markets, notwithstanding the challenges of the pandemic. There is an acute lack of availability in the prime market, given the flight to quality trend playing out and a very limited amount of prime stock in these markets. In particular, tenants seeking prime space in Surry Hills and Eveleigh have very few options, as evidenced by sub 2% vacancy.

**Sector demand, by market**

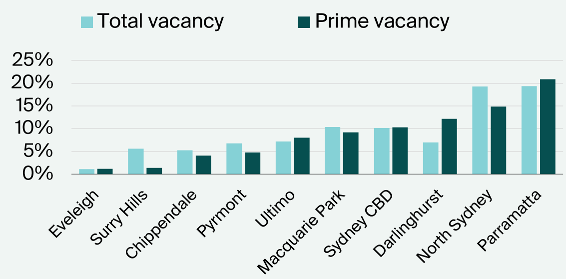
5 year average, %




Source: Knight Frank Research

**Vacancy by market**

Total vs prime, %, as at July-22




Source: Knight Frank Research

# STRUCTURAL SUPPLY SHORTAGE

## Structural under supply of prime space

There is a clear undersupply of prime stock across the city fringe, in a market that is increasingly demanding high quality office accommodation. Prime grade space on average accounts for under 30% of total fringe stock, compared to over 60% in the CBD. Surry Hills the largest fringe market which has a prime composition of just 12%, with Ultimo also very low at 29%.

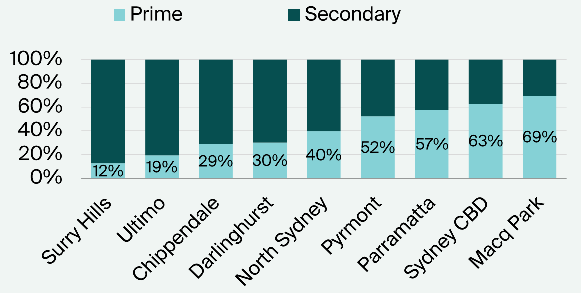
## Strong demand for new development stock, but a limited pipeline

Against this backdrop, recent development completions across the fringe markets have performed very well. In Pymont, 21 Harris Street (18,888sqm) achieved near full occupancy prior to PC, while 100 Broadway (5,450sqm), Chippendale, was 100% committed to UTS. More recently, Mirvac's Locomotive workshop (31,075sqm) was predominantly leased prior to completion. And in Surry Hills, boutique developments at 1-51 Foveaux Street (10,241sqm) and 52 Reservoir Street (2,496sqm) have seen strong interest and already substantially committed.

The future development pipeline in the fringe remains limited with only boutique size projects expected to be delivered in the coming years. The Brewery Yard development is already sustainably pre-committed to Afterpay, whilst the Oxford & Foley development in Darlinghurst has achieved high commitments on its commercial component prior to any works commencing. The limited pipeline presents opportunity for potential developers to enter the market given the limited competition for new space and would be well received by the market.

### Composition of office stock

By market, %




Source: Knight Frank Research

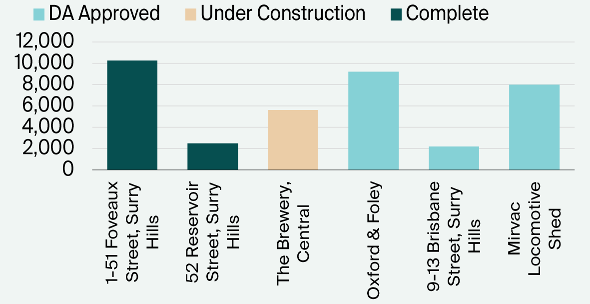
## Refurbishments helping to fill the gap

An entrenched lack of supply and a desire to tap into the cultural and heritage features of buildings within the fringe has led to increased focus on refurbishing and upgrading existing stock. For instance, 29-43 Balfour Street, Chippendale, was successfully converted from a warehouse to A grade office accommodation. Examples like this demonstrate that the 'flight to quality' arguably encompasses a flight to creative spaces, and this continues to reward owners who upgrade to meet the evolving needs of tenants.

Looking ahead, with few opportunities for large-scale development outside of the Central precinct, the fringe is likely to remain under-supplied relative to the growth of the underlying tenant base seeking prime grade space. In this environment, more owners are likely to seek to upgrade existing assets and rental performance relative to other Sydney markets will continue to be strong.

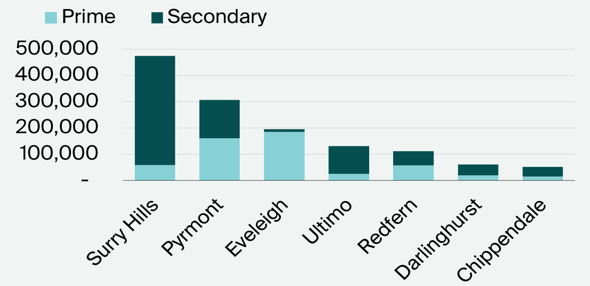
### City fringe developments

By status,sqm




### Total office stock

Prime v secondary, sqm




Source: Knight Frank Research/RCA

# REVITALISING CENTRAL PRECINCT

*Central precinct to benefit from large-scale urban regeneration over the next decade*

### Expansion of the CBD to amenity rich southern boundary and fringes

Historically the city fringe and its Southern boundaries have been underutilised as an office market destination and regarded as the poorer cousin of the core CBD markets. However, over the past decade the market has outperformed and demonstrated its potential to catch up with more established precincts.

This outperformance can be attributed to demand and supply side factors. On the demand side, the growth of the technology sector and wider creative industries has been a key driver, because these businesses tend to seek a less traditional office environment. They are often location-agnostic or with a preference for the city fringe, linked to its vibrant amenity, ability to help shape brand identity and appeal to potential new hires.

On the supply side, the geographical boundaries of the CBD and height restrictions within the CBD core have always meant that over time, the traditional core would spill-over to expand into the fringe due to capacity constraints. Reflecting this, the growth of total stock in the core markets has slowed down, with new markets in the fringe and separately in Parramatta now playing a greater role in the overall Sydney landscape.

These constraints have heightened the demand for fringe locations from developers recognising the market's long-term potential both as a natural extension to the CBD, and as a market growing organically in its own right with a distinctly different feel. A notable example is Eveleigh, which has undergone extensive development over the last few years with the activation of ATP and CBAs 100,000sqm office footprint in the precinct, which would have been more difficult to achieve within the core CBD.


### Vision for Tech Central to become global leader for innovation and technology

Aligned with these trends, the Government's vision is to establish Central Precinct as an innovation cluster driven by knowledge-sharing industries and supported by adjacent health and education corridors. The area is designated as a state-significant precinct covering 24 hectares bounded by Pitt Street to the west, Cleveland Street to the south, Eddy Avenue to the north and Elizabeth Street to the west.

At the forefront of the vision is Tech Central, which is earmarked for up to 250,000sqm of commercial space with the aim to house start-ups, scale ups and innovation ecosystem partners, aspiring to host 25,000 employees by 2036. Already within the orbit of Tech Central are large health and education institutions including the University of Sydney, University of Technology Sydney, Royal Prince Alfred Hospital and CSIRO's Data61, which will enhance research and collaboration across industries.

Atlassian has committed to establish its new HQ in a new 75,000 sqm tower at the heart of the precinct. The tower will be developed by Dexus and aims to achieve 6 Star NABERS rating, with completion scheduled for 2026. In addition, Dexus and Frasers plan to deliver a further twin-tower development totalling c133,000 sqm. Completion is expected by early 2027.

# STRONG RENTAL PERFORMANCE TO CONTINUE

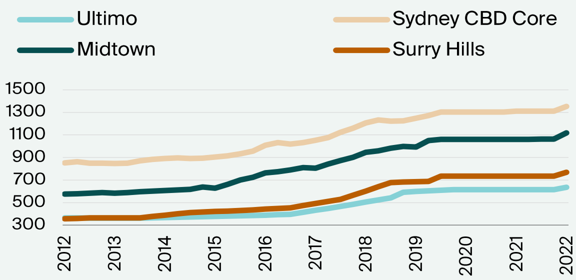
## Rental growth across fringe markets outperforming competing markets

Rents in the fringe have traditionally been far lower that the prevailing levels in Sydney CBD. However, over the past decade the markets have shown substantial growth and partly closed the gap with the major CBD precincts. Over the last five years the Sydney CBD has seen net effective growth of 12%, whilst the fringe markets have at least doubled this, in particular Pyrmont and Surry Hills have grown 60% and 40% respectively. More recently, the fringe markets were resilient through the pandemic and experienced a more moderate decline in effective rents.

In general, net face rents across the fringe markets range between $600-$800/sqm for prime space, although best-in-class assets are now seeing rents in excess of $1,000/sqm being achieved. Despite recent growth, city fringe rents remain competitive against other Sydney markets. On a net face basis, the rental discount spread ranges between 40-50% between the various fringe markets and the Sydney CBD.

**Average prime net face rents**

By market, $/sqm



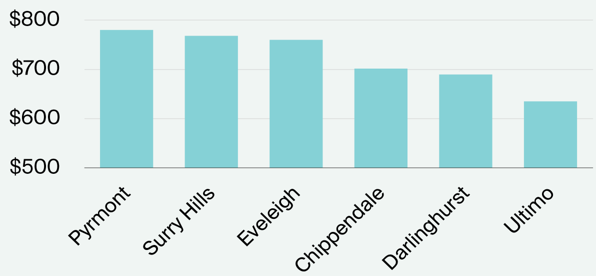

Source: Knight Frank Research

## Further catch-up growth potential

Looking ahead, the low vacancy rate for prime stock and sustained demand mean that the outlook for further growth remains strong as the Sydney office market recovers post-pandemic. While Tech Central will bring forward significant new supply over th e next decade, the surrounding fringes precincts will remain tight and the experience of other global markets such as London points to significant long-term growth potential as the fringe markets mature.

**Net face rent**

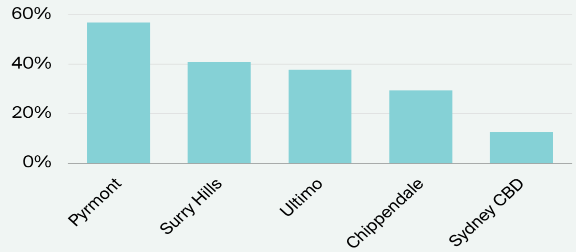
By market, $/sqm




Source: Knight Frank Research

**5 year net effective growth rate**

By market, %




Source: Knight Frank Research

### Recent significant tenant commitments

| OCCUPIER | PROPERTY | SIZE SQM | GROSS FACE RENT $/SQM | TERM YRS | START DATE |
|---|---|---|---|---|---|
| **Afterpay#** | The Brewery, Central Park | 3,663 | 1,200 | 5 | H2 2023 |
| **LegalVision~** | 241 Commonwealth Street, Surry Hills | 1,250 | 850 | 3.5 | Apr-22 |
| **SpeedX~** | 8 central Avenue, South Eveleigh | 3,006 | 872 | 3.5 | Mar-22 |
| **Medium Rare Content~** | 21 Harris Street, Pyrmont | 1,595 | 1,050 | 5 | Jan-22 |

# Pre-commitment ~Existing space

# INVESTORS EXPRESS CONFIDENCE IN THE FRINGE

## Investment activity rebounds

Following a sharp pandemic-induced fall in investment activity in 2020, office sales in the city fringe rebounded in 2021. Investment volume totalled $747 million in 2021, nearly three times more than in 2020 and 26% higher than the average over the five years to 2019.

Driving investment activity in 2021 was Sunsuper's acquisition of the Locomotive Workshop and the National Innovation Centre (1 Locomotive Street) in South Eveleigh for $231.4 million from Mirvac, and Charter Hall Long WALE REIT's purchase of the Red Cross Blood Service HQ (17 O'Riordian Street) in Alexandria for $159 million from AIP Asset Management.

Investor momentum has continued into 2022, with Elanor Investor Group recently acquiring 19 Harris Street, Pyrmont for $185 million from AEW Capital on a passing yield of 4.25% with a 2.5 year WALE, which underpins the strength of core prime assets in the fringe.

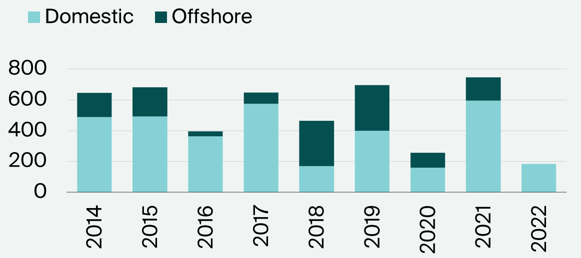
Investment activity will likely hit record levels by the end of 2022 with a number of major assets currently on market gaining strong interest.

## Yields remain firm despite pandemic uncertainty

Prime office yields in the city fringe have remained firm at record low levels over the past two years despite the uncertainty arising from the pandemic, underscoring the sustained investor demand for fringe assets.

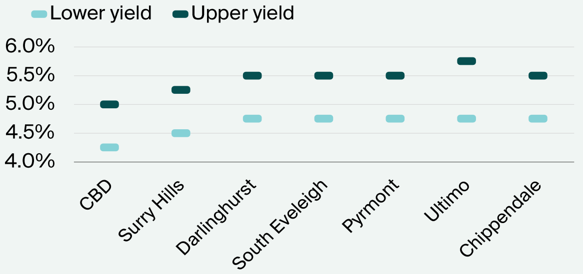
Prime office yields in Surry Hills remain relatively low, with assets in the suburb particularly sought after by investors. At the lower end of the range, yields for the highest quality assets in Surry Hills are trading with a small spread to CBD assets at 4.50%. However, there is a larger variation in yields among assets in most city fringe locations. The yield at the upper end of the range in Surry Hills for example is 5.25%, 75 basis points higher than the lower end. Yields in Darlinghurst, South Eveleigh, Pyrmont are slightly softer between 4.75% and 5.5%.

**Sydney fringe office sales $10m+**
By purchaser ($m), domestic v offshore, ast Jun-22




Source: Knight Frank Research

**Sydney fringe prime office yields**
Per cent




Source: Knight Frank Research

### Recent significant sales

| PROPERTY | PRICE $M | CORE MARKET YIELD % | NLA SQM | $/SQM NLA | WALE | PURCHASER | VENDOR | SALE DATE |
|---|---|---|---|---|---|---|---|---|
| **19 Harris Street, Pyrmont** | 185 | 4.25^ | 12,549 | 14,742 | 2.5 | Elanor Investors | AEW Capital | Mar-22 |
| **39-47 Regent Street, Chippendale** | 68.5 | 4.20 | 3,844 | 17,820 | 10.0 | Private investor | Ninety Four Feet | Oct-21 |
| **1 Locomotive Street, South Eveleigh (49%)** | 231.4 | 4.70 | 31,000 | 15,234 | 10.2 | Sunsuper | Mirvac | Aug-21 |
| **17 O'Riordian Street, Alexandria** | 159.0 | 4.51 | 12,701 | 12.519 | 9.8 | Charter Hall* | AIP Asset Management | Jun-21 |

^Passing Yield * Charter Hall Long WALE REIT

## DATA DIGEST

**City Fringe Stock definition:** Includes Suburbs in Surry Hills, Pyrmont, Darlinghurst, Ultimo, Chippendale, Redfern, Eveleigh. Office stock generally above 1,500sqm
**Prime Grade:** Asset with modern design and/or recent development, good condition & amenity. Rents achieved in these assets are generally upper end range of the average band.
**WALE:** Weighted Average Lease Expiry
Charts and data reflected in report are as at July 2022.

### 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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