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*Solid economic
drivers in CBD fringe*

2

*Under-supply of
prime stock*

3

*Rental growth
outperforming*



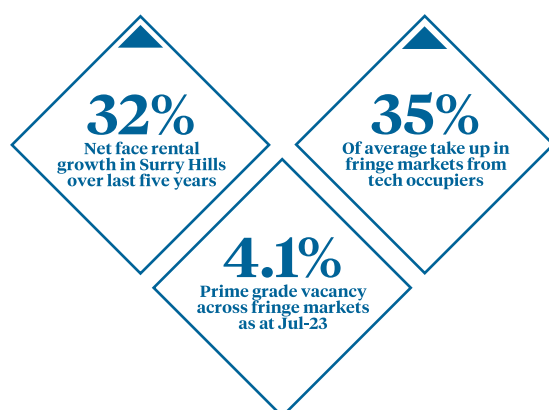
Sydney City Fringe

knightfrank.com/research

Office Insight, 2023



EVOLVING CBD FRINGE A DESTINATION OF CHOICE FOR OCCUPIERS AND INVESTORS



“The favourable demographic profile offers ready access to talent, and the appeal of co-locating alongside likeminded businesses in close proximity to major health and education precincts are compelling for many occupiers.”

The Key Insights

Economic growth in inner Sydney has significantly outpaced that of Greater Sydney, which has grown on average by 3.9% per annum compared to Greater Sydney at 2.3% per annum.

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 20% in the CBD.

There is an acute lack of availability in the prime market, in particular, tenants seeking prime space in Surry Hills, Darlinghurst and Eveleigh have very few options, as evidenced by sub 2% vacancy.

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

On a net face basis, the rental discount spread ranges between 38-50% 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 cater to 25,000 jobs by 2036.

City Fringe office market indicators—July 2023

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	2.9	1.4	700-900	25-35	5.50-6.25
Pymont	304,345	7.2	6.7	700-900	25-35	5.75-6.50
Eveleigh	195,118	1.4	0.8	700-850	25-35	5.75-6.50
Ultimo	130,716	5.7	10.6	600-750	25-35	5.75-6.75
Redfern	111,474	4.2	6.4	550-750	25-35	5.75-6.75
Darlinghurst	60,772	1.5	1.3	600-850	25-35	5.75-6.50
Chippendale	51,423	5.8	10.6	600-850	25-35	5.75-6.50
Total	1,328,805	4.1	4.1			

Source: Knight Frank Research/Arealytics ^{*}assuming WALE 5.0 years [^]Incentives are on a Gross basis

POSITIVE ECONOMIC DRIVERS IN THE FRINGE

Sydney and its fringes a strong and resilient local economy

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, Pyrmont, Ultimo, Chippendale, and Redfern) totalled \$141 billion in 2022, recording its strongest level of annual growth and has more than doubled over the past two decades (growing at an average rate of 3.9% per annum). Economic growth in inner Sydney has significantly outpaced that of Greater Sydney, which has grown by 60% (or 2.3% per annum) over the same period. Reflecting this stronger growth, the City of Sydney's share of total Greater Sydney output rose from 22% in 2002 to 30% in 2022.

Open borders facilitating the resumption of 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 35%, well in excess of the growth experienced by other major economies including the US (17%), UK (14%), France (9%), Germany (2%) and Japan (-3%).

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. While global migration flows were disrupted by the pandemic, they have now improved with no

more restrictions, in particular a major influx of overseas students this year which has had a profound impact on the fringe given the location of universities in the precinct.

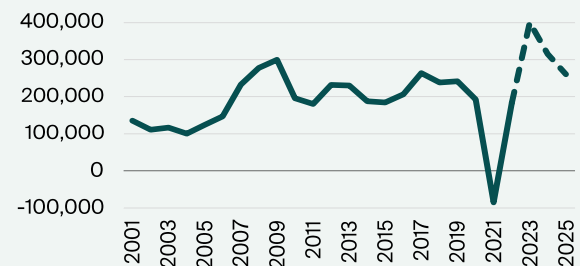
Sydney's CBD and inner fringe have enjoyed particularly strong population growth (53%) over the past two decades compared with 29% growth rate for Greater Sydney, with most inner city suburbs recording significantly stronger population growth than the Sydney average.

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 and Professional services accounted for 29.1% of gross value added (GVA) in 2021, compared with 23% in 2001. 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.

Net overseas migration

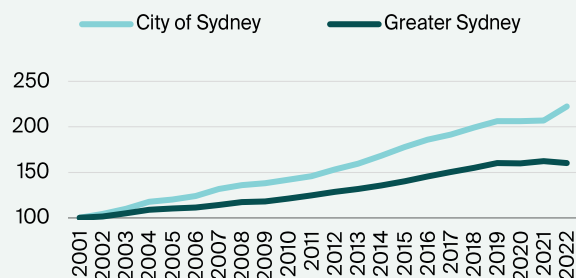
Australia - annual total



Source: Knight Frank Research, ABS

Gross Regional Product

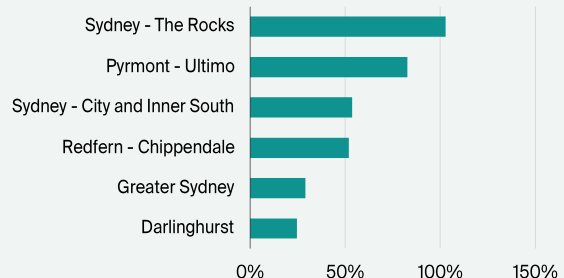
Index, 2001 = 100



Source: Knight Frank Research, .id

Population growth, 2002-2022

Per cent



Source: Knight Frank Research, ABS

FAVOURABLE DEMOGRAPHICS IN THE FRINGE

Young and highly skilled workforce across the CBD and fringe

Inner city Sydney has a relatively young adult population. Over 42% of Sydney's CBD and city fringe population were between 20 and 34 years of age as at the 2021 Census, nearly double the 22% share for Greater Sydney. The CBD, Pyrmont-Ultimo, and Redfern-Chippendale have a particularly high share of people within this age cohort, ranging between 38% and 50%. Surry Hills and Darlinghurst have relatively higher shares of 25-34-year-olds at 33% and 31% respectively.

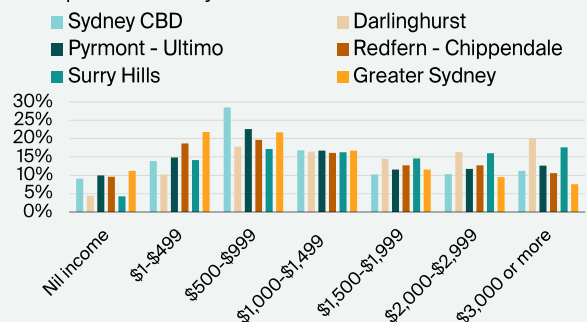
Sydney's inner-city population is relatively highly educated. Around half of the resident population of the Sydney CBD and city fringe hold a bachelor's degree compared to 44% for Greater Sydney. Rates of tertiary educational attainment are evenly spread across the city fringe suburbs with between 47% and 51% of the population of Darlinghurst, Pyrmont-Ultimo, Redfern-Chippendale, and Surry Hills holding a bachelor's degree. Similarly, nearly a quarter of inner-city Sydney residents hold postgraduate qualifications compared with 19% for Greater Sydney.

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 20% and 17.6% of residents respectively have a total weekly income of \$3,000 or more, more than double the 7.5% 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 12.7% and 10.6% respectively.

Income distribution

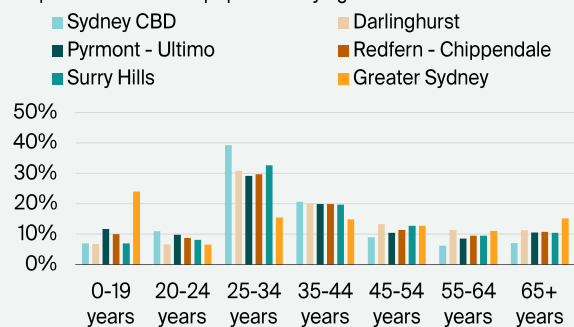
Total personal weekly income



Source: Knight Frank Research, ABS

Age distribution

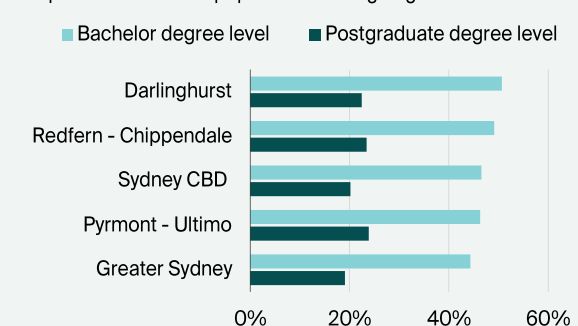
Proportion of resident population by age



Source: Knight Frank Research, ABS

Educational attainment

Proportion of resident population holding degree



Source: Knight Frank Research, ABS

SOUGHT AFTER OFFICE MARKET

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 like minded businesses in close proximity to major health and education precincts 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 (20% on average). Examples of new entrants include Sony and Dovetail pre-committing to 3,358 and 4,355sqm respectively at the Oxford and Foley development in Darlinghurst. In Pyrmont, Wellcom worldwide has leased 2,282sqm at 100 Harris Street whilst ITV studios secured 1,976sqm at 19 Harris Street.

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.

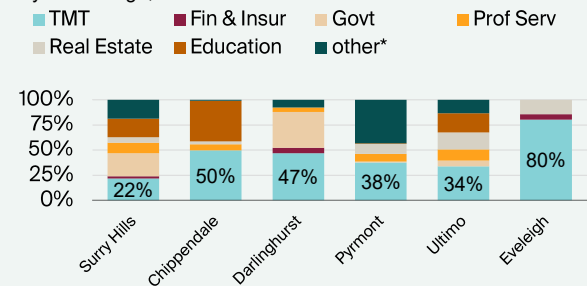
For example, Chippendale and Ultimo have a high proportion of education and tech occupiers accounting for 90% and 53% respectively of average 5 year take-up, while Pyrmont hosts an established digital cluster and Real Estate occupiers. Surry Hills is a larger market with a more diverse tenant mix that is less oriented around technology, while the larger scale of recent development in Eveleigh has facilitated major commitments from Tech and data science.

Vacancy tracks significantly lower to other Sydney office markets

Occupier demand and limited new supply over the past decade has led to overall vacancy in all the major fringe markets tracking below the Sydney CBD and major metro markets. 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, Darlinghurst and Eveleigh have very few options, as evidenced by sub 2% vacancy.

Sector demand, by market

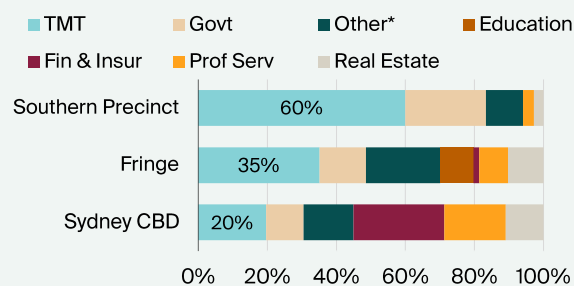
5 year average, %



Source: Knight Frank Research

Lease deals by Industry Sector

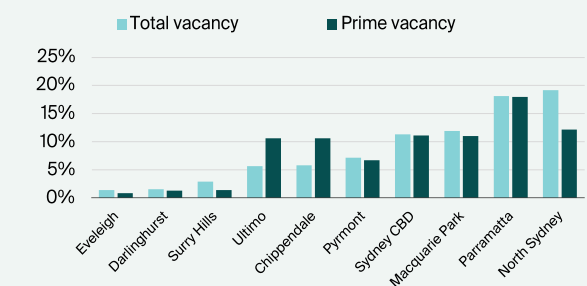
5 year average by market



Source: Knight Frank Research

Vacancy by market

Total vs prime, %, as at July-23



Source: Knight Frank Research

SHORTAGE OF PRIME QUALITY STOCK

Limited prime grade office stock

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 19%.

Short term pipeline remains limited to boutique size developments

Against this backdrop, development completions across the fringe markets have historically performed very well. Mirvac's Locomotive workshop (31,075sqm) was predominantly leased prior to completion. In 2022, boutique developments at 1-51 Foveaux Street (10,241sqm) and 52 Reservoir Street (2,496sqm) were completed and have now achieved near full occupancy.

The future development pipeline in the fringe remains limited with only boutique size projects expected to be delivered over the next 12-18 months. The Brewery Yard development is already sustainably pre-committed to Afterpay, whilst the Oxford & Foley development in Darlinghurst has achieved high commitments to Sony and Dovetail on its commercial component.

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.

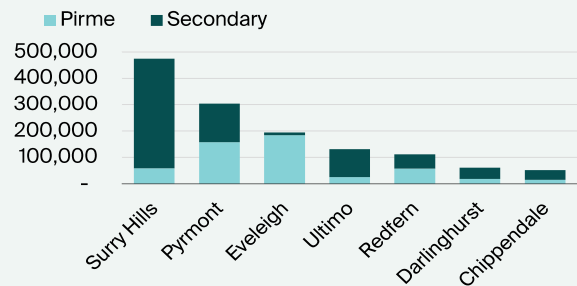
Refurbishments and conversions helping to fill the gap

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, this is similar to the Brewery Yard development currently under construction. 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.

Total office stock

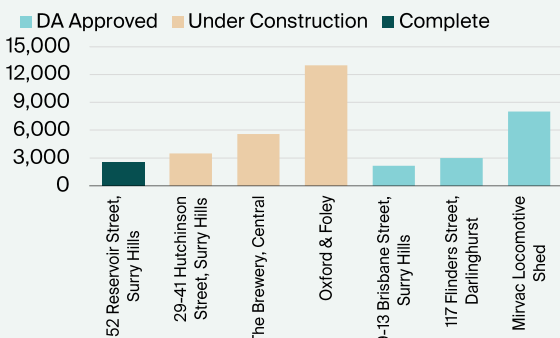
Prime v secondary, sqm



Source: Knight Frank Research/Arealytics

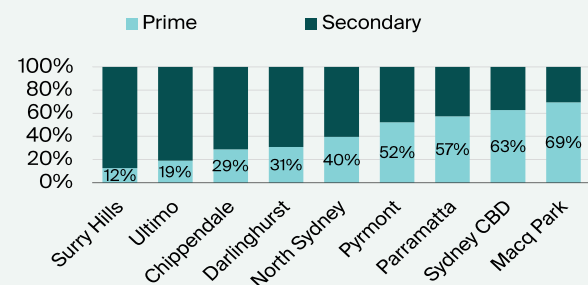
City Fringe Developments

By Status, Sqm



Composition of office stock

By Market, %



Source: Knight Frank Research/Arealytics

REVITALISATION OF 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 Dexu and aims to achieve 6 Star NABERS rating, with completion scheduled for 2027. In addition, Dexu and Frasers plan to deliver a further twin-tower development totalling c133,000 sqm. Completion is expected by early 2028.

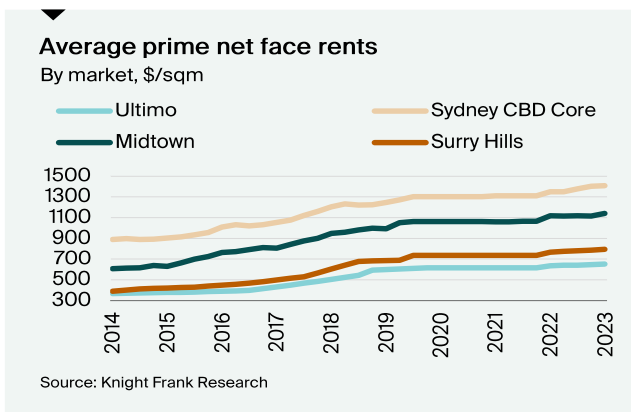


POSITIVE RENTAL GROWTH

Rental growth across fringe markets outperforming competing markets

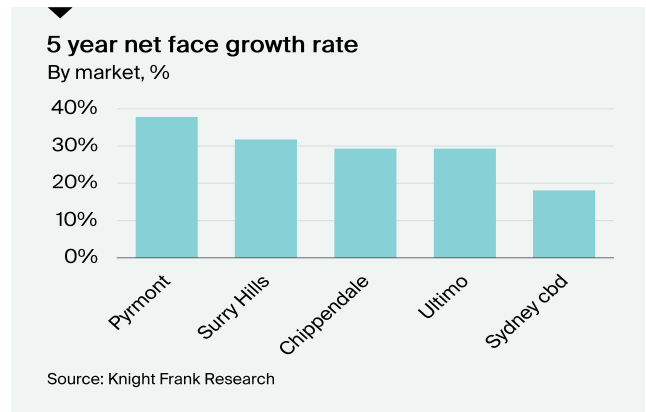
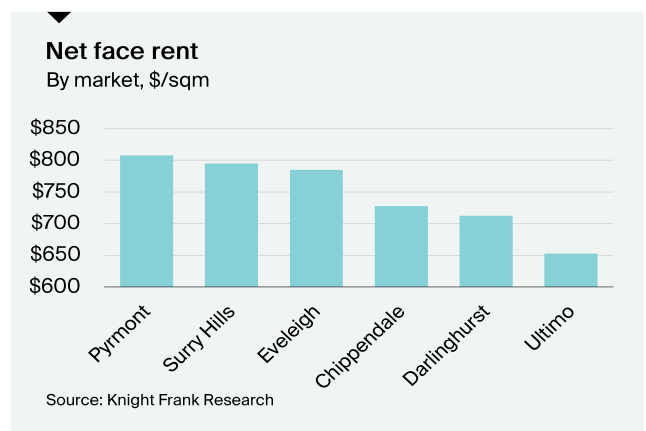
Rents in the fringe have traditionally been far lower than the prevailing levels in Sydney CBD. However, over the past decade the markets have shown substantial growth and partly closed the gap with the major CBD precincts. Over the last decade the Sydney CBD has seen net face rental growth of 65%, whilst the fringe markets have seen higher growth, in particular Pyrmont and Surry Hills have grown over 100% in the same period. 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 various fringe markets have experienced strong growth over the past 18 months, averaging over 6%, which now see average net face rents range between \$650-\$850/sqm for prime space. Best-in-class assets now regularly achieve net rents in excess of \$1,000/sqm. Despite recent growth, city fringe rents remain competitive against other Sydney markets. On a net face basis, the rental discount spread ranges between 37-50% between the various fringe markets and the Sydney CBD.



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 the 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.



Recent significant tenant commitments

OCCUPIER	PROPERTY	SIZE SQM	GROSS FACE RENT \$/SQM	TERM YRS	START DATE
Dovetail#	60 Oxford Street, Darlinghurst	4,355	1,260	7	2024
iTV~	19 Harris Street, Pyrmont	2,000	875	5	Q1 23
Johnson & Johnson	45 Jones Street, Ultimo	3,825	800	2	Q1 23
Work club~	1 Locomotive, South Eveleigh	3,500	956	10	Q4 22

Pre-commitment ~Existing space

LONG TERM INVESTOR CONFIDENCE

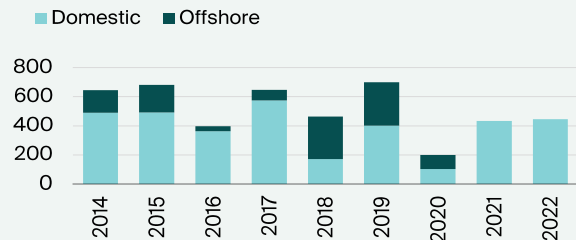
Reduced deal activity as asset pricing resets

The impact of higher funding costs on pricing has been apparent, with reduced deal activity across all office markets nationally, with a number of investors opting to sit on the sidelines and wait for conditions to stabilise. Transaction volumes in the City Fringe totalled \$444.8 million in 2022, this is down only 11% on the 10 year average, which in comparison to other major markets highlights its resilience and confidence in the market.

Driving investment activity in 2022 was Shakespeare Group's acquisition of 285a Crown Street in Surry Hills from LaSalle Investment, the property was sold on a 4.9% core market yield for \$116.2 million. Furthermore late last year, Canva acquired 8-24 Kippax Street, an unrenovated and vacant office building for \$123.25m and is expected to refurbish and occupy the asset as its new headquarters. Transactional activity will likely remain subdued in 2023 as experienced across all markets as vendor and purchaser expectations reset on the back of the increasing cost of debt.

Sydney fringe office sales \$10m+

By purchaser (\$m), domestic v offshore



Source: Knight Frank Research/RCA

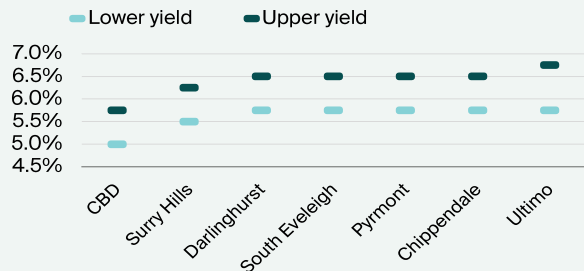
Yield softening playing out

The sharp rise in rates has directly impacted funding costs and hedging costs for investors. The increase in the cost of debt since mid 2022 has now filtered through to the market and caused a dramatic shift in sentiment. This trend is echoed nationally and in other global markets given the universality of inflationary pressures and rate rises, but the CBD and fringe remain a preferred destination aided by favourable demographic and demand drivers.

This shift in sentiment has resulted in yield softening across the market. Prime office yields in the city fringe and CBD are judged to have softened by 100bps since mid last year. 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. However, there is a larger variation in yields among assets in most city fringe locations, which trade at a discount to the CBD and are an attractive proposition for investors.

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
8-24 Kippax Street, Surry Hills	123.2	5.56	8,408	14,659	0.6	Canva	KMS	Nov-22
285a Crown Street, Surry Hills	116.2	4.90	4,727	24,582	6.1	Shakespeare Group	LaSalle Investment	Jun-22
19 Harris Street, Pyrmont	185	4.83	12,549	14,742	2.5	Elanor Investors	AEW Capital	Mar-22
1 Locomotive Street, South Eveleigh (49%)	231.4	4.70	31,000	15,234	10.2	Sunsuper	Mirvac	Aug-21

*Passing Yield

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 2023

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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