

North Shore Office Market



March 2024

The structural shift of flight to quality is significant in North Sydney as there is a clear divergence in demand for quality assets.

knightfrank.com.au/research




Key Insights

Deal flow to improve as sentiment and economic outlook has become more clear




Marco Mascitelli
Associate Director, RESEARCH & CONSULTING

 **6.8%**

Premium grade vacancy

In North Sydney, lowest compared to all CBD precincts and other major NSW markets.

 **-11K**


Overall net absorption

Negative net absorption in the six months to Jan-24 in North Sydney.

 **42k**

Sqm of new supply in 2024

New development in Macquarie Park across three new buildings.

 **1.5%**


Annual face rental growth

Prime net face rents average \$894/sqm in North Sydney, an increase of 1.5% y/y.

 **105bps**

Yield softening y/y

Prime yields in North Sydney softening by 105bps y/y to average 6.3%

 **\$258m**

2023 transaction volumes

Transactional activity at its lowest level in over a decade for 2023 across the North Shore markets

North Shore Office Market Indicators – January 2024

Market	Grade	Total Stock sqm	Vacancy Rate %	6 Mths Net Absorption sqm	6 Mths Net Additions sqm	Average Net Face Rent \$/sqm	Average Incentive % ^	Core Market Yield %*
North Sydney	Prime	391,537	20.5	-1,426	12,501	894	35-40	6.00-6.50
North Sydney	Secondary	545,377	26.9	-9,860	-8,230	734	35-40	7.25-7.75
North Sydney	Total	936,914	24.2	-11,286	4,271			
St Leonards	Prime	137,256	25.1	3,498	1,933	659	35-40	7.25-7.75
St Leonards	Secondary	222,301	27.1	-9,352	0	573	35-40	7.75-8.25
St Leonards	Total	359,557	26.3	-5,854	1,933			
Chatswood	Prime	129,730	21.3	-4,826	0	631	33-38	7.25-7.75
Chatswood	Secondary	141,273	16.5	-2,434	0	520	33-38	7.75-8.25
Chatswood	Total	271,003	18.8	-7,260	0			
Macquarie Park	Prime	664,503	21.0	-5,277	42,800	460	33-38	6.25-7.25
Macquarie Park	Secondary	271,549	18.0	-3,738	0	383	33-38	7.75-8.25
Macquarie Park	Total	936,052	20.1	-9,015	42,800			

^ Incentives are on a gross basis; * assuming WALE 5 years
Source: Knight Frank Research/PCA

North Sydney

PREMIUM ASSETS OUTPERFORMING

Whilst tenant enquiry and deal flow has been steady, net absorption remains weak across North Sydney, stemming primarily from the secondary market. Overall net absorption in the six months to January 2024 totalled negative 11,286sqm, which has led to an increase in vacancy to measure 24.2% as at January 2024.

The structural shift of flight to quality is significant in North Sydney as there is a clear divergence in demand for quality assets. Premium vacancy in North Sydney is tight at 6.8%. Best in class assets in North Sydney; 100 Mount Street, 1 Denison Street, 118 Mount Street and 2-4 Blue Street are sitting with strong occupancy rates, outperforming other assets in the market. Recent examples of occupiers upgrading their space include Pacific National leasing 3,350sqm at 2-4 Blue Street, relocating from 15 Blue Street, additionally Ventia has secured 3,500sqm at the upcoming Victoria Cross development, they will relocate from 80 Pacific Highway in 2025.

MARKET WELL PLACED TO ABSORB CURRENT STOCK

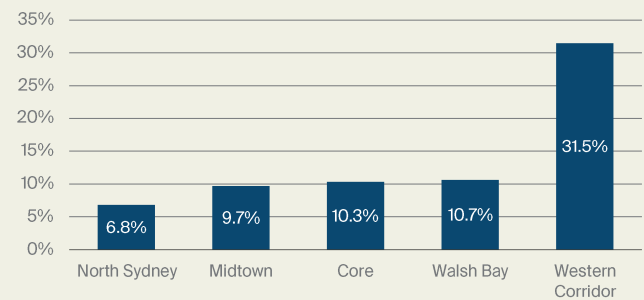
The completion of 88 Walker Street (12,501sqm) late last year followed the completion of 2-4 Blue Street in early 2023. This takes the total office stock base to 936,914sqm which is the second largest metropolitan office market in NSW; of which prime grade stock accounts for 41% of the market, up from 25% ten years ago. The next major development for North Sydney is Lendlease's Victoria Cross OSD (55,000sqm) due for completion in 2025. Beyond this, there are a number of DA approved and pre-commit led developments in the pipeline including Affinity Place (59,000sqm), 173 Pacific Highway and 155 Walker Street. These schemes are projected to be delivered from 2028, allowing for current stock levels to be absorbed by the market.

NET EFFECTIVE RENTS POISED FOR GROWTH

There has been subdued growth in face rents in North Sydney, with average prime net face rents increasing by 1.5% over the year to measure \$894/sqm (\$1,052/sqm gross) as at January 2024. Similarly, in the secondary market, growth has been limited to 0.4% over the year to currently measure \$734/sqm (\$881/sqm gross face). Incentives edged higher over the year to now average 37% which has resulted in negative net effective growth of 2.7% in the prime market to average \$505/sqm. Incentives have likely peaked and will stabilise over the near term which will see net effective rents return to growth.

Premium grade vacancy by market

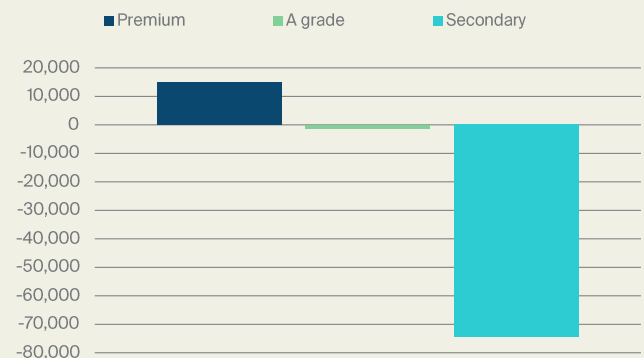
As at Jan-24



Source: Knight Frank Research, PCA

North Sydney office demand by grade

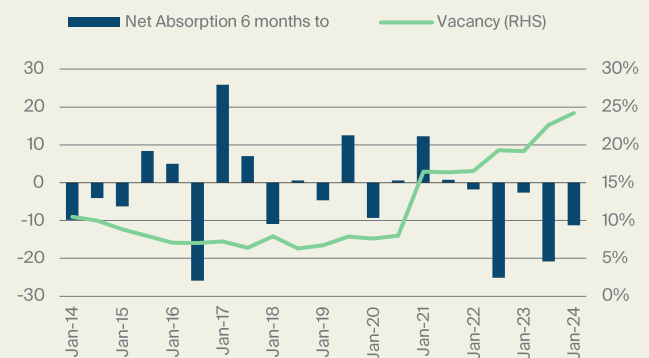
Total absorption 2021-23 ('000sqm)



Source: Knight Frank Research

North Sydney vacancy and net absorption

'000 sqm, %



Source: Knight Frank Research, PCA

Macquarie Park

SUPPLY DRIVEN RISE IN VACANCY

The vacancy in Macquarie Park has surged to a historical high of 20.1% over the second half of 2023. While compared with the North Shore markets, the vacancy is slightly higher than Chatswood and remains below North Sydney and St Leonards.

Whilst absorption has been weak, the rise in vacancy has also been supply led with new developments contributing over 42,000 sqm of prime space to the market in H2 2023, one of the strongest periods of supply additions on record. Net absorption over the same period recorded negative 9,015 sqm which also contributed to the rise in vacancy.

By building grade, prime vacancy increased from 14.7% to 21.0% in six months to January 2024, with negative net absorption of 5,277 sqm. Secondary vacancy was up from 16.7% to 18.0% in the second half of 2023, with net absorption recorded at negative 3,738 sqm.

DECADE-HIGH DEVELOPMENTS IN 2023

The second half of 2023 saw 1 Eden Park Drive (c. 10,000 sqm), 396 Lane Cove Road (c. 18,000sqm) and the first stage of M_Park at 11 Khartoum Road (c. 16,800 sqm) reaching practical completion. The 42,800 sqm of new supply added is a decade high for half yearly completions. This resulted in office stock now totalling 936,000 sqm, closely behind North Sydney and Parramatta by size. With 71% of the stock being prime grade, Macquarie Park has the highest proportion of prime stock across NSW.

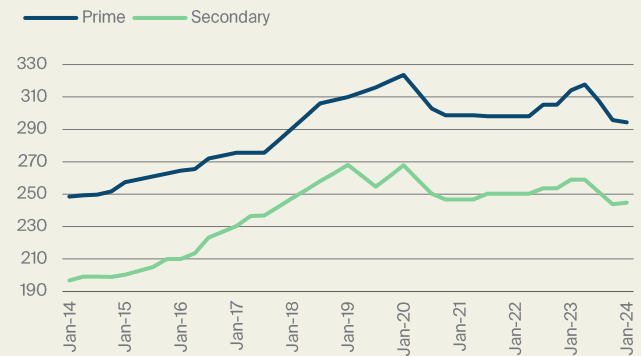
Looking ahead, the next stage of M_Park at 15 & 17 Khartoum Road (c. 25,000 sqm) is currently under construction and scheduled for completion in 2025.

ELEVATED INCENTIVES HINDER NET EFFECTIVE RENTS

The new prime grade developments in the market have aided prime net face rental growth by 4.0% y/y to average \$460/sqm (\$576/sqm gross face). Secondary net face rent followed the trend rising 3.4% y/y to \$383/sqm (\$498/sqm gross face). Similar to competing North Shore markets, incentives in Macquarie Park remain elevated and have increased over the year to now average 36% as at January 2024, however notably some landlords are offering higher incentives than this in order to retain and attract tenants. The rise in incentives has offset any net face rental growth, with prime net effective rents declining by 6.3% y/y to average \$294/sqm. Secondary net effective rents have dropped 5.5% y/y to now average \$245/sqm.

Macquarie Park net effective rents

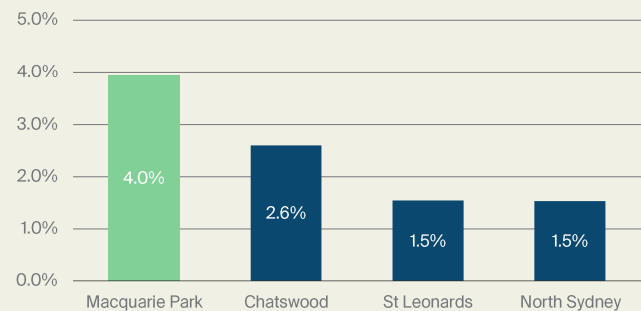
Average rent by grade, \$/sqm



Source: Knight Frank Research

North Shore office annual rental growth

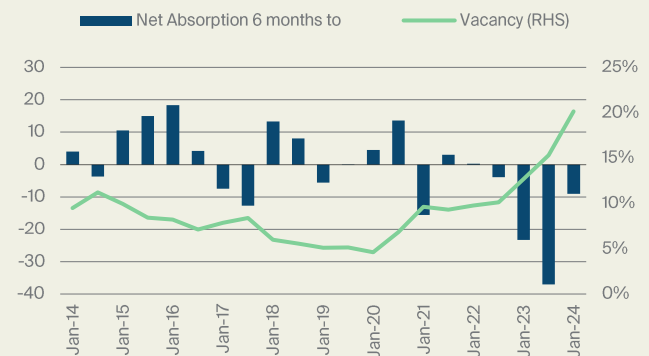
Net face rental growth, %



Source: Knight Frank Research

Macquarie Park vacancy and net absorption

'000 sqm, %



Source: Knight Frank Research, PCA

St Leonards

WEAK ABSORPTION HINDERS VACANCY LEVELS

Weak absorption levels in St Leonards continues as the market has remained subdued given competition across other North Shore markets. With 558 Pacific Highway, one of the largest developments in a decade to enter the market in 2023 at a time of constrained demand, overall vacancy has risen to its highest level on record of 26.3% as at January 2024.

By grade, the prime market has seen a slight decrease in vacancy in the six months to January 2024, to measure 25.1%, notably there is no prime sub-lease vacancy, unlike competing markets where sub-lease vacancy is well above average. There has been solid enquiry for the 558 Pacific Highway development which has already seen multiple deals signed including Richard Crookes, GHD and Rural Affinity. In the secondary market, occupier demand has been constrained given the structural shift of flight to quality with demand heavily weighted towards prime assets. As a result, negative absorption of 9,352sqm was recorded in the six months to January 2024, leading to an increase of vacancy to 27.1%, the highest level on record.

HEALTHCARE PRECINCT AND METRO TO AID DEMAND

The North Shore health care precinct has established itself as one of the world class healthcare and educational hubs and is at the forefront for healthcare-related real estate as an institutional investment target. This will not only appeal to investors but also have a positive impact on demand with occupiers, seeking prime grade amenity in proximity to a health and education precinct.

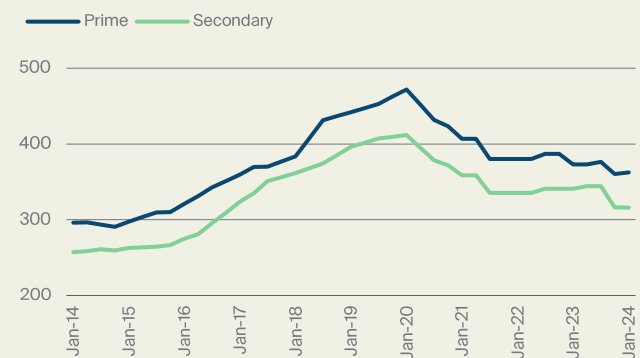
With the Crows Nest Metro station scheduled for delivery this year, this will only enhance the appeal of the precinct to occupiers. With the increased prime grade availability and the arrival of new stock there will be strong appeal to occupiers in secondary assets to upgrade, which will likely see a greater divergence between the prime and secondary grade.

MODERATE PRIME FACE RENTAL GROWTH, WHILST INCENTIVES REMAIN ELEVATED

Given the high vacancy levels and subdued demand across St Leonards face rental growth has been limited. Average prime net face rents currently measure \$659/sqm (\$801/sqm gross) an increase of 1.5% over the 12 months to January 2024. Incentives remain elevated to average 37%. In the secondary market average net face rents have remained steady over the year to average \$573/sqm (\$694/sqm gross).

St Leonards office net effective rent

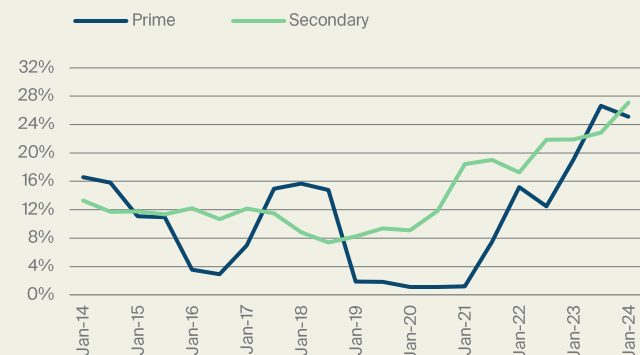
Average rent by grade, \$/sqm



Source: Knight Frank Research

St Leonards office vacancy

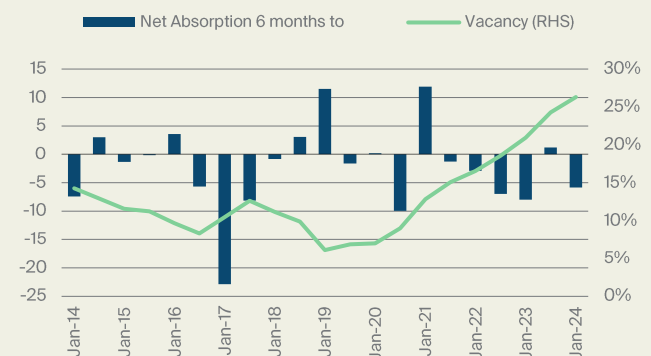
% by grade



Source: Knight Frank Research, PCA

St Leonards office vacancy and net absorption

'000 sqm, %



Source: Knight Frank Research, PCA

Chatswood

VACANCY RISES

Overall vacancy in Chatswood currently measures 18.8% as at January 2024, this is the only North shore market recording sub 20% vacancy. Direct vacant space in Chatswood increased to 17.4% over the year, up from 15.9%; whilst sub lease vacancy measures 1.4%. Annual net absorption was negative 1,464sqm.

More specifically, prime vacancy has seen an increase from 17.6% to 21.3% over the six months to January 2024, driven by negative net absorption of 4,826 sqm. Similarly, secondary vacancy was reported at 16.5%, up from 14.5% six months prior, with net absorption of negative 2,434 sqm.

Looking ahead, there are no major office developments scheduled in Chatswood in the near term which will aid the recovery of the market and help absorb current stock levels.

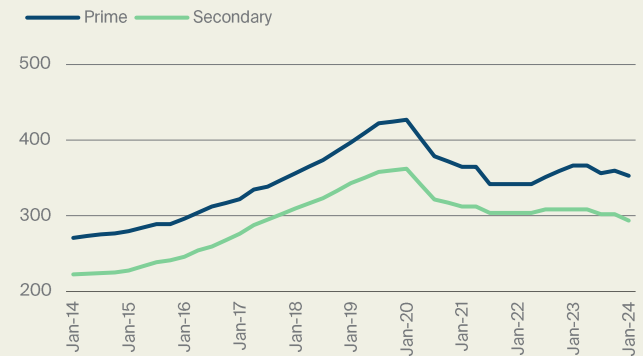
INCENTIVES EDGING UP

Average prime net face rents in Chatswood currently measure \$631/sqm (\$773/sqm gross), representing a 2.6% increase over the year to January 2024. The secondary net face rents reported a 3.3% increase over the year to average \$520/sqm (\$647/sqm gross). The Zenith Tower, considered the best in class building in Chatswood, can achieve net face rents over \$700/sqm. The current rental discount between prime and secondary rents sits at 18%.

Prime incentives have edged up to 36%, decreasing net effective rents to \$353/sqm, reflecting a 3.8% annual decline. Average secondary incentive has increased to 35%, dropping the net effective rent by 4.8% to \$294/sqm over the year.

Chatswood net effective rents

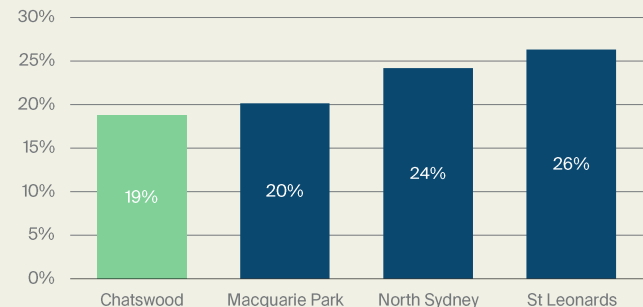
Average rent by grade, \$/sqm



Source: Knight Frank Research

North Shore office vacancy

Overall vacancy, %



Source: Knight Frank Research

North Shore office annual net absorption

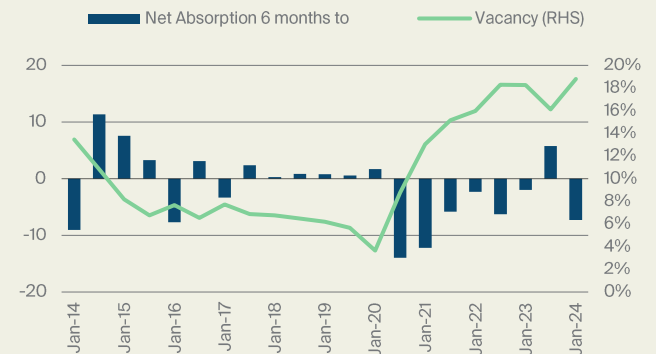
By market, '000 sqm



Source: Knight Frank Research

Chatswood vacancy and net absorption

'000 sqm, %



Source: Knight Frank Research, PCA

North Shore investment

DEAL FLOW TO INCREASE AS SENTIMENT AND ECONOMIC OUTLOOK IMPROVES

Increased debt costs and economic uncertainty throughout 2023 encouraged many investors to sit on the sidelines, while vendors opted to wait until sentiment improved before bringing assets to market. As a result, deal flow was at a record low; totalling \$258.8 million across three transactions in North Sydney and one in Macquarie Park. The largest transaction was Dexus selling 124 Walker Street, North Sydney, late last year, acquired by a Singaporean family for \$95.5 million on a 7.7% core market, the sale price represented a 20% discount to the assets June-23 book valuation.

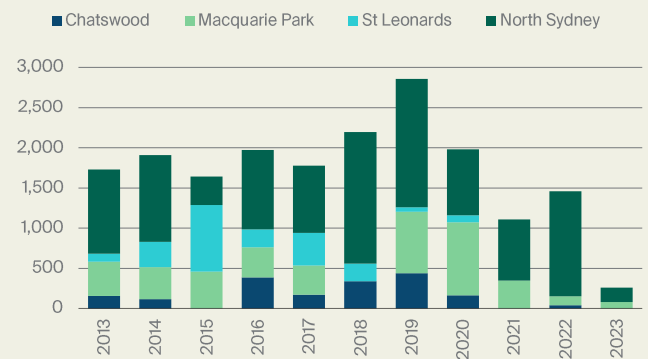
RESET IN YIELDS

The average prime and secondary yields in the North Sydney market have expanded 105bps and 137bps over the last 12 months to average 6.3% and 7.4% respectively. The current yield spread between prime and secondary markets in North Sydney is well above trend at 114bps. The average prime yields in the rest of North Shore markets currently range between 7.00% and 7.50%, while secondary yields range between 7.75% to 8.25%.

With yields having substantially reset and the macro picture more encouraging, deal flow is likely to pick up as more investors return to acquisition mode and assets begin on market campaigns along with many also shopped around off market. The disconnect between vendor and purchaser expectations and bid spread over the last 18 months is starting to close as fruition of declining book values come through which will further aid deal flow.

North Shore office sales \$10m+

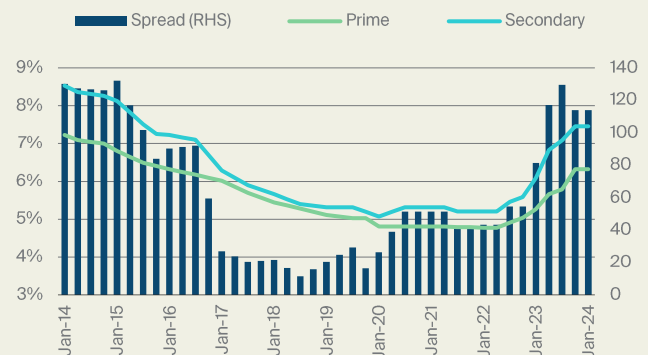
By precinct (\$m), 2013 to 2023



Source: Knight Frank Research

North Sydney office yields

Prime vs secondary



Source: Knight Frank Research

Recent significant sales

Property	Price \$ m	Core Market Yield %	NLA sqm	\$/sqm NLA	WALE	Purchaser	Vendor	Sale Date
124 Walker St, North Sydney	95.5	7.7	11,006	8,677	1.8	Ho-Group	Dexus Wholesale Property Fund	Dec-23
54 Miller St, North Sydney	72.1	7.1	6,964	10,353	1.8	Private	AEW Capital	Dec-23
81-83 Walker St, North Sydney	10.5		897	11,706		Private	2Hourtoner	Dec-23
5 Eden Park Dr, Macquarie Park	80.7	5.3	11,556	6,988	3.1	HealthCo Healthcare Wellness REIT	Australian Unity Office Fund	Feb-23

Source: Knight Frank Research



Recent significant tenant commitments

Occupier	Property	Precinct	Size sqm	Face Rent \$/sqm	Incentive %	Start Date
Audika~	11 Khartoum Road	Macquarie Park	1,800	505	35%	Nov-23
Key Pharma~	396 Lane Cove Road	Macquarie Park	1,000	490	30\$	Oct-23
FreeCity~	8 Khartoum Road	Macquarie Park	679	430	35%	H2 2023
Pacific National~	2-4 Blue Street	North Sydney	3,350	U/D	U/D	H2 2024
Ventia	Victoria Cross	North Sydney	3,500	U/D	U/D	2025

Pre-commitment ^ Sublease ~ Direct * Renewal (g) gross face
Source: Knight Frank Research

North Shore major office supply

Property	Area (sqm)	Developer	Stage	Timing
88 Walker Street, North Sydney	13,000	Billbergia	Complete	H2 2023
Macquarie exchange stage 1, 396 Lane Cove Road	18,000	Frasers/Winten	Complete	H2 2023
Array – Building B, 1 Eden Park drive, Macquarie Park	10,000	Kador Group	Complete	H2 2023
M_Park Stage 1, 11 Khartoum Road, Macquarie Park	16,800	Stockland	Complete	H2 2023
Victoria Cross OSD, North Sydney	55,000	Lendlease	U/C	H2 2025
Affinity Place, North Sydney	59,000	Stockland	DA Approved	2028
173 Pacific Highway, North Sydney	11,000	Maville Group	DA Approved	2028+
153-157 Walker Street, North Sydney	45,000	GPT	Mooted	2030+

Refurbishment
Source: Knight Frank Research



We like questions, if you've got one about our research, or would like some property advice, we would love to hear from you.



Research & Consulting
Marco Mascitelli
+61 2 9036 6656
Marco.Mascitelli@au.knightfrank.com



Office Leasing
Euan Matheson
+61 2 9028 1109
Euan.Matheson@au.knightfrank.com



Capital Markets
Jonathan Vaughan
+61 2 9036 6729
Jonathan.Vaughan@au.knightfrank.com



Research & Consulting
Ben Burston
+61 2 9036 6756
Ben.Burston@au.knightfrank.com



Office Leasing
Andrea Roberts
+61 2 9036 6703
Andrea.Roberts@au.knightfrank.com



Capital Markets
Ben Schubert
+61 2 9036 6870
Ben.Schubert@au.knightfrank.com



Research & Consulting
Naki Dai
+61 2 9036 6673
Naki.Dai@au.knightfrank.com



Valuations & Advisory
Tim Barwick
+61 2 9028 1101
Tim.Barwick@au.knightfrank.com



Capital Markets
Dominic Ong
+61 2 9036 6747
Dominic.Ong@au.knightfrank.com

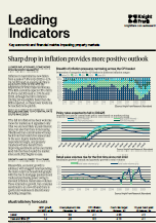


Capital Markets
Will Brassil
+61 2 9036 6618
Will.Brassil@au.knightfrank.com

Recent Research



Sydney CBD Report
2024



Economic Indicators Report



Build to rent report



Australia Industrial Report



Active Capital Report
2023



Brisbane Development



Important Notice © Knight Frank Australia Pty Ltd 2024 – This report is published for general information only and not to be relied upon in any way. Although high standards have been used in the preparation of the information, analysis, views and projections presented in this report, no responsibility or liability whatsoever can be accepted by Knight Frank Australia Pty Ltd for any loss or damage resultant from any use of, reliance on or reference to the contents of this document. As a general report, this material does not necessarily represent the view of Knight Frank Australia Pty Ltd in relation to particular properties or projects. Reproduction of this report in whole or in part is not allowed without prior written approval of Knight Frank Australia Pty Ltd to the form and content within which it appears.