- *Activity to pick up once restrictions ease*
- *Face rents are holding but incentives remain above average*
- *Greater presence of domestic based capital*

Knight Frank

North Shore Office

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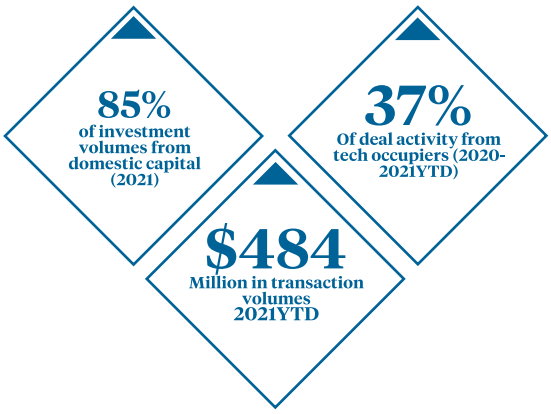
Market Report, September 2021

CONFIDENCE IN THE MARKET REMAINS STRONG



"...previous trends shows a significant rebound in transactions following the easing of restrictions and signs of recovery in the economy."

The Key Insights

The momentum gained in the first half the year has put Australia in a position of strength, which will aid in the next stage of the economic recovery.

With no new significant supply anticipated for North Sydney until at least 2024 the market is well placed to absorb the current availability of stock and drive vacancy down.

2021 is showing a greater presence of domestic based capital, with these investors accounting for 85% of investment volumes and offshore funds only 15%.

Stabilisation of prime yields expected but still scope for compression due demand from opportunistic investors for assets with development upside.

North Shore Office Market Indicators—July 2021

MARKET	GRADE	TOTAL STOCK SQM	VACANCY RATE %	SIX MONTH NET ABSORPTION SQM	SIX MONTH NET ADDITIONS SQM	AVERAGE NET FACE RENT $/ SQM	AVERAGE INCENTIVE %^	AVERAGE CORE MARKET YIELD %*
North Sydney	Prime	364,536	13.9	16,087	0	834	30-35	4.50-5.00
North Sydney	Secondary	558,257	18.0	-15,311	0	701	30-35	5.00—5.50
North Sydney	**Total**	**922,793**	**16.4**	**766**	**0**			
St Leonards	Prime	115,300	7.5	57	7,388	634	30-35	5.00-5.50
St Leonards	Secondary	223,135	19.0	-1,313	0	558	30-35	5.75-6.25
St Leonards	**Total**	**333,435**	**15.1**	**-1,256**	**7,388**			
Chatswood	Prime	132,181	17.8	-2,969	0	578	30-35	5.25-6.00
Chatswood	Secondary	141,273	12.6	-2,841	0	497	30-35	5.50-6.00
Chatswood	**Total**	**273,454**	**15.1**	**-5,810**	**0**			
Macquarie Park	Prime	631,600	9.2	5,667	0	420	30-35‡	5.25-5.75
Macquarie Park	Secondary	273,110	10.3	-6,238	0	358	30-35‡	5.75-6.25
Macquarie Park	**Total**	**904,710**	**9.6**	**-15,573**	**10,676**			

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

NORTH SYDNEY

Flight to quality trend driving demand

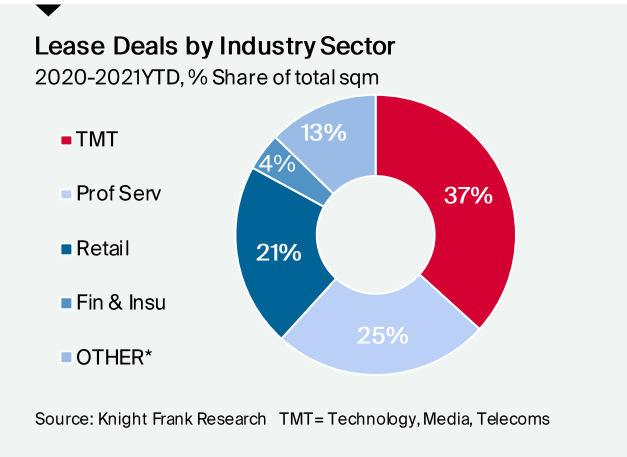
North Sydney experienced a strong pick up in activity and enquiry in the backend of 2020 which filtered through to the first half of 2021 (prior to the current lockdown), which has seen overall vacancy in North Sydney stabilise at 16.4% as at July-21. Given the record influx of new supply throughout 2020 the market has faired well with overall positive net absorption of 776 sqm.

The crystallisation of several large lease deals across North Sydney's developments completed last year has resulted in a significant decline in premium grade vacancy from 17.7% down to 6.1% in the six months to July-21.

On an annual basis, net absorption of 50,537 sqm has been recorded for the premium grade market, emphasising the demand and flight to quality trend for top end assets. Specifically, 1 Denison is now over 90% committed with 118 Mount Street likely to be at this status by year end.

Lease deal activity thus far in 2021 has already more than doubled the levels of 2020, with the tech sector remaining the most dominant industry type with 37% share of deals, whilst professional services accounts for 25%.

Additionally, market evidence highlights occupiers seeking whole floor options rather than suites, with over 67% of deals being done across the 500-2500 sqm size range. This is in stark contrast with the Sydney CBD where 56% of deals are being done in the sub 500 sqm range. Several new lease deals at 118 Mount Street include Equigroup, Finclear and Cover-More Group, each securing whole floors.



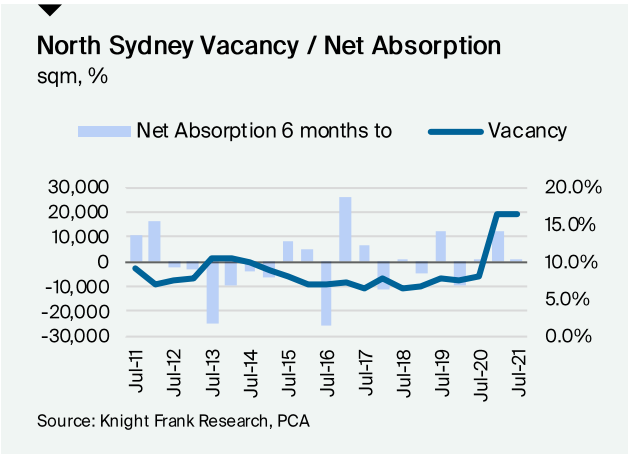
No significant new supply in the short term bodes well for demand

Following a year of record development activity for North Sydney, which saw over 100,000 sqm of new supply added to the market, development activity has now eased with no new supply added to the market over the first half of 2021. Only two boutique developments are under construction; 88 Walker Street by Billbergia Group, which will encompass 13,000 sqm of commercial space across a mixed use development, furthermore Thirdi Group has commenced initial site works at 2 Blue Street (14,000 sqm), however is still awaiting a pre-commitment.

With no new significant supply anticipated until at least 2024 when the Victoria Cross OSD is completed the market is well placed to absorb the current availability of stock and drive vacancy down to pre-Covid levels, especially in the prime market where tenants have previously been unable to obtain a foothold in North Sydney due to lack of availability.

Rental growth halts and incentives rise

Rental growth has remained subdued since the onset of the pandemic. On average, prime net face rents have remained steady in July 2021, measuring $834/sqm ($985/sqm gross face). Landlords continue to offer above average incentives in order to attract tenants which has put downward pressure on effective rents. Prime incentives average 32.5% as at July 2021, up from 26.3% in July 2020. This has led to net effective rents dropping by 10.4%YoY to measure $514/sqm. Similarly, in the secondary market net face rents are unchanged at $701/sqm ($844/sqm gross face) as at July 2021. Secondary incentives average 30%, resulting in net effective rents dropping by 7.5% to record $448/sqm.



ST LEONARDS

Constrained demand hinders vacancy levels

There has been limited deal activity in the St Leonards office market since the onset of the pandemic with the only major movement circulating around the relocation of NSW Health into the Royal North Shore Health Precinct in the last 12 months. The limited activity, coupled with a rise in sublease availability, has seen overall vacancy rise to 15.1% as at July 2021, up from 12.8% six months prior.

By grade, the prime market has seen vacancy increase to 7.5% up from record low of 1.2% in the six months to July 2021, still well below the long run average. The completion of 7 Westbourne Street (7,388 sqm) by Dexus, which has achieved a commitment rate of c70% in conjunction with sublease vacancy rising from zero to 2.4% over the same period, have been the main drivers in the increase in prime vacancy.

The secondary market, which saw a significant rise in vacancy throughout 2020, has since stabilised measuring 19% as at July 2021, up from 18.4% over the last six months.

Thriving healthcare precinct and new development to drive future demand

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

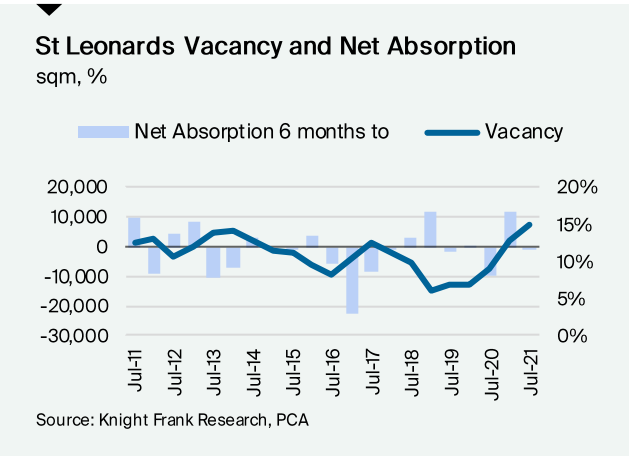
Furthermore, the mixed use developments currently under construction at 500 Pacific Highway by Landmark and the JQZ development at 550 Pacific Highway will add a further 20,000 sqm of prime office space to the market over the next 18 months, in conjunction with new retail amenity and improved public domain for St Leonards. With the Crows Nest Metro station to be delivered by the end of 2024 this will only enhance the appeal of the precinct to occupiers.

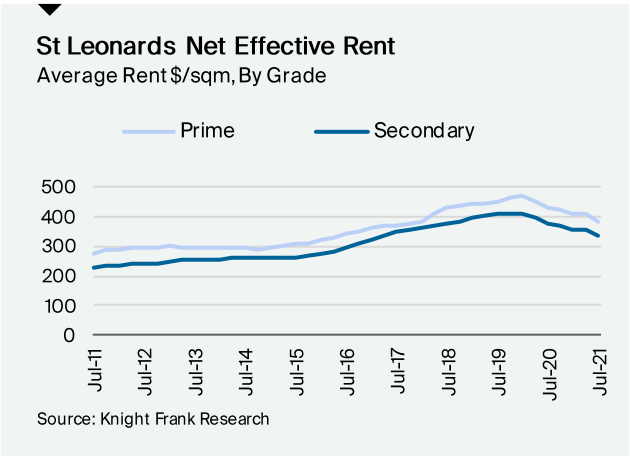
The occupier preference for quality stock within the market is clear and with an increase in prime supply the divergence between prime and secondary stock will likely continue. Recent movements include health care sector tenants Ality and Asterx moving into A grade office space at 601 Pacific Highway, both previously in secondary space.

Rents halt and incentives rise

Amidst the limited tenant demand, the above trend rental growth rates experienced over the last few years have halted. Similar to competing markets, face rents have held stable while incentives have risen as owners seek to attract and retain tenants. Average prime incentives have increased to 33%, decreasing net effective rents to $380/sqm, down 11.9% in the 12 months to July 2021. Average secondary incentives have risen to 33%, declining net effective rents by 11.4% to $336/sqm.

On a 12 month basis (to July 2021), average prime net face rents are stable at $634/sqm ($770/sqm gross face) and average net face secondary rents are $558/sqm ($673/sqm gross face), also unchanged since January 2020.





CHATSWOOD

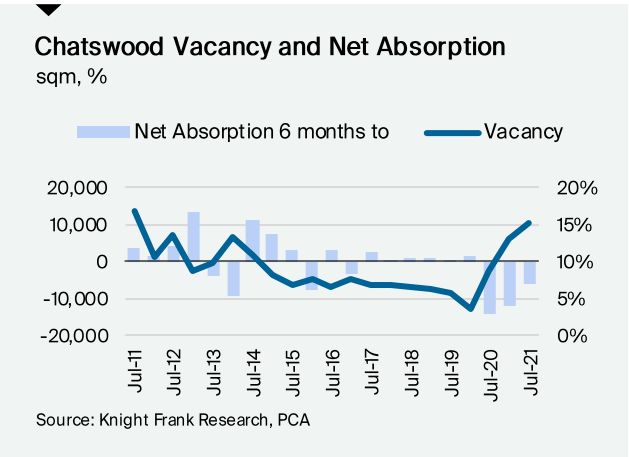
Rising sublease space and limited tenant activity continues to impact vacancy levels

Limited tenant activity in the Chatswood office market over the last 18 months in conjunction with a rise in sublease availabilities have been the catalyst for Chatswood vacancy rate more than tripling over this period and hitting a decade high.

Several direct whole floors have come back to the market and sublease vacancy has also increased. After reaching a 20-year low of 3.7% in January 2020, total vacancy in Chatswood rose to 15.1% in July 2021. All grades recorded an increase in vacancy over the period, with total net absorption declining by 5,810sqm in the six months to July 2021

More specifically, sublease vacancy has risen to 3% as at July 2021, up from 0.4% in July 2020. The rise in sublease vacancy stems from the availability of several whole floors at 799 Pacific Highway (Citadel towers) and 821 Pacific Highway (Zenith Towers).

Additionally, the relocation of the NSW Department of Health from the Zenith Towers to St Leonards has added further backfill space to the towers following the departure of Transport for NSW to Macquarie Park in 2020.

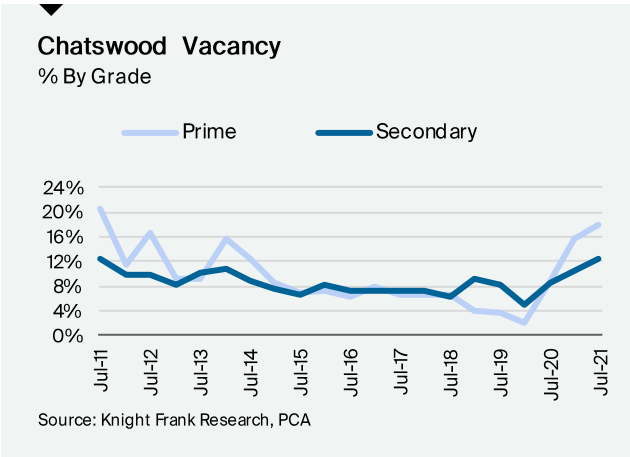


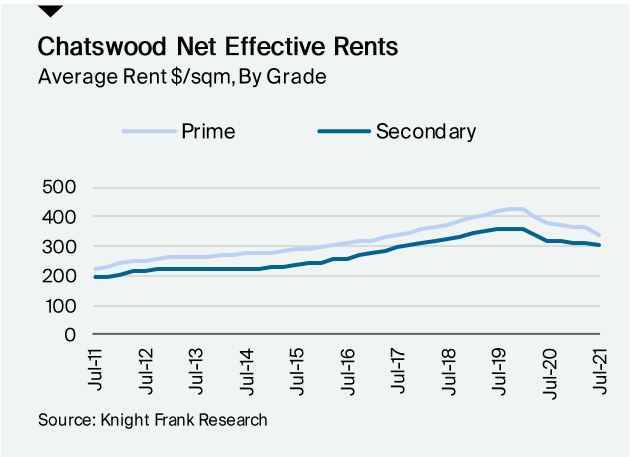
Rental growth holds and incentives lift

The subsequent increase in vacancy levels has halted any face rental growth and seen average incentives rise consistently since the onset of the pandemic.

Average prime incentives have increased to 33%, decreasing net effective rents to $342/sqm, down 6% in the six months to July 2021, and down 9.8% YoY. Average secondary incentives have risen to 31.2%, declining net effective rents by 5.5% to $304/sqm on a 12 month basis.

On a 12 month basis (to July 2021), average prime net face rents are unchanged at $578/sqm ($716/sqm gross face). Similarly, secondary rents remained steady in the 12 months to July 2021 to $497/sqm ($619/sqm gross face).





MACQUARIE PARK

Flight to quality driving prime vacancy down

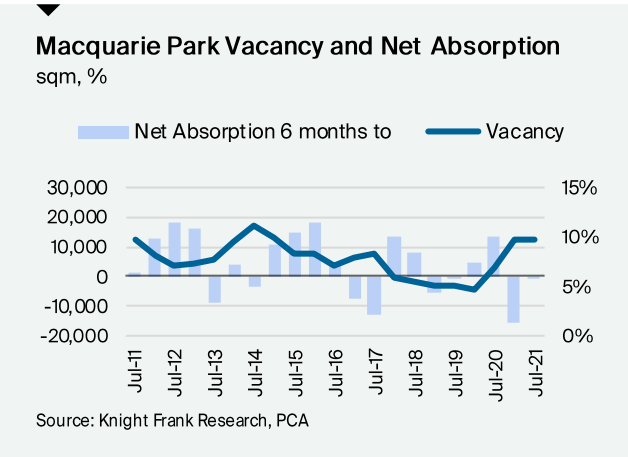
Vacancy increased to 9.7%, as at July 2021, up from 9.6% in January 2021 and up from 6.8% at the same time last year, with a contraction in secondary grade office space demand offsetting any positive absorption indicators in prime space.

By building grade, prime vacancy decreased to 9.2% in July 2021, down from 10.1% in January 2021 and 5,667 sqm of positive net absorption was recorded. Secondary vacancy increased from 8.6% in January 2021 to 10.9% in July 2021 and negative net absorption of 6,238sqm.

The pandemic-imposed disruption to office utilisation rates has seen a number of secondary grade tenants downsize space requirements as they move to a hybrid or flexible workplace model. Flight to quality has also been a contributing factor to a decline in secondary grade occupancy, with the pandemic increasing demand for buildings with higher ranked indoor environmental qualities, such as air systems and the office layout.

Pent-up leasing demand from 2020 buoys volumes in Q1 and Q2

Leasing activity declined in 2020 to about half the volume seen in 2019 due to Covid market conditions. However, prior to the current outbreaks, the economy had begun recovering from the pandemic at a stronger than anticipated pace and there was a strong uptick in confidence levels as workers returned to the office.



The delay in decision making on relocation, expansion or new requirements last year generated considerable pent-up demand during Q1 and Q2 leading to an 11% rise in leasing volumes on 2020.

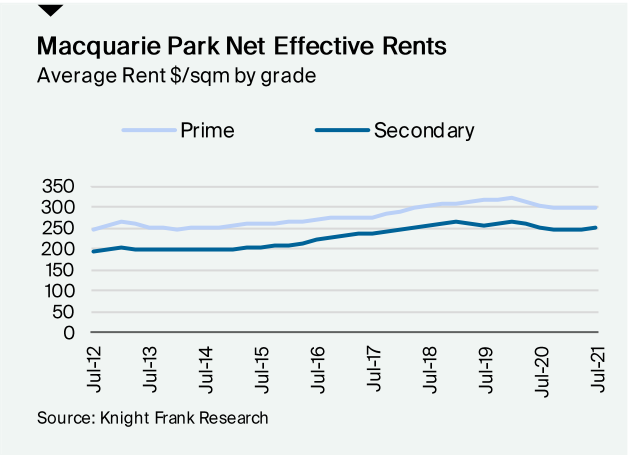
Increasing demand from occupiers relocating from competing precincts

While Macquarie Park office precinct has traditionally been supported by established industry clusters, including government, tech, pharma and biotech, there are early signs that a widening range of occupier types are relocating from competing precincts. As well as highlighting the flight to quality demand trend, the move to Macquarie Park is potentially indicative of increasing demand from some employers seeking to be located closer to where their workers live.

Goodman Fielder recently subleased 4,100 sqm of Fujitsu's former space at 118 Talavera Road, relocating from North Sydney. Rockwell Automation has subleased 557 sqm at 16 Giffnock Avenue and will be relocating from Lane Cove. In another deal, Petbarn (Greencross Vets) has leased c2,706 sqm at 1 Epping Road, North Ryde, and will be relocating their headquarters from Chatswood.

Prime incentives have increased, reflecting the arrival of new development stock

Prime incentives have increased in the July quarter to average 29%, up from 28% in April 2021, leading to a slight 0.2% decrease in net effective rents over the quarter to $298/sqm. On a net face basis, prime rents have increased 1.9% q-q, reflecting the addition of new stock over the last 12 months.



NORTH SHORE INVESTMENT

Investment demand remains high but lack of supply hindering activity

$484.4 million investment volumes have been recorded in the first half of the year across the North Shore markets, with activity tapering off since the lockdown was imposed in June. Volumes for the first half of 2021 are up 17% on the same time last year but still below average.

The previous trend shows a significant rebound in transactions following the easing of restrictions and signs of recovery in the economy, with almost 80% of last year's transactions occurring during Q3 and Q4 when there was news of a stronger than anticipated GDP result and a strong rebound in consumer spending, jobs growth and business investment.

There seemed to be a clear shift in buyer strategy to target assets in growth areas, particularly those associated with the Sydney Metro project with Macquarie Park and North Sydney the most active target investment locations. Of the North Shore markets, Macquarie Park and North Sydney remain the most active in 2021, accounting for 70% and 30% of investment volumes over the first half.

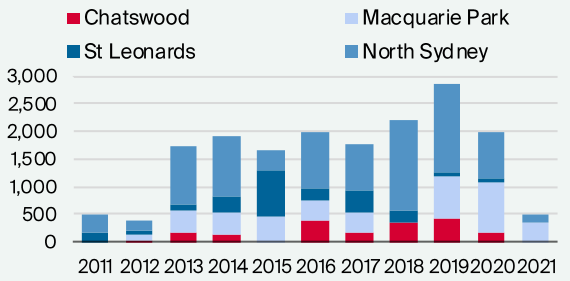
Domestic investors gaining ground as they support the investment market

Notably, in contrast to last year, where offshore investors accounted for 66% of acquisitions, 2021 is showing a greater presence of domestic capital, with home-grown investors accounting for 85% of investment volumes and offshore funds only 15%.

Offshore funds have accounted for around 57% of acquisitions since 2013, so a rapid de-escalation of this activity this year suggests that international travel restrictions and border closures are now hindering activity. In a positive sign, the low volume of transactions and shortage of assets being put to the market also implies that landlords are putting divestments on hold, despite indicators that yields are holding at near lows in most precincts.

Stabilisation of prime yields expected but still scope for compression due to investor interest

Average prime office yields have remained stable since the onset of the pandemic in all markets except Macquarie Park, which has dominated activity recently. Yields in Macquarie Park have compressed by 25bps q-q. This is the first time since 2019 yields have shifted, reflecting the strong occupational market and appetite from opportunistic investors for assets with development upside, as well as growing demand for decentralised but well-connected suburban office assets.



North Shore Office Sales $10m+
By Precinct ($m), 2011 to 2021

Source: Knight Frank Research

Recent significant sales

PROPERTY	PRICE $M	CORE MARKET YIELD %	NLA SQM	$/SQM NLA	WALE	PURCHASER	VENDOR	SALE DATE
60 Miller Street, North Sydney	275.0	5.2	19,415	14,164	3.1	Private Offshore	Dexus	Oct-20^
37 Epping Road, Macquarie Park	55.0	5.42	8,067	6,818	3.2	Charter Hall	RF CorVal	Jun-21
68 Waterloo Road, Macquarie Park	106.5	5.09	13,486	7,897	4.1	Private	AMP Capital ~	Mar-21
44-50 Waterloo Road, Macquarie Park	71.0	N/A	7,156	9,922	N/A	ESR	AMP Capital ~	Mar-21
3 Richardson Place, North Ryde	115.0	6.15	17,187	6,691	2.9	Quintessential Equity	Goodman	Mar-21
65 Berry Street, North Sydney	211.8	4.95	14,507	14,601	2.3	Intera Group	Charter Hall	Dec-20

*Initial Yield ~AMP Capital Diversified Property Fund ^Settled September 2021

North Shore major office supply

Address	Region	Area (sqm)	Developer	Major Tenants	Commitment level (%)	Stage	Est. Date of Compl
1 Denison Street	North Sydney	60,338	Winten Property	Nine, Microsoft, SAP	90%	Complete	H2 2020
118 Mount Street	North Sydney	20,770	Zurich	Zurich	75%	Complete	H2 2020
RNS Hospital Southern Campus	St Leonards	27,000	NSW Govt	NSW Health	100%	Complete	H2 2020
Macquarie Corporate Centre	Macq Park	14,700	Goodman	Schneider	75%	Complete	H2 2020
7 Westbourne Street	St Leonards	7,388	Dexus	Multiple	75%	Complete	H1 2021
500 Pacific Highway	St Leonards	3,285	Landmark	-	-	U/C	H2 2021
88 Walker Street	North Sydney	13,000	Billbergia	-	-	U/C	H2 2022
558 Pacific Highway	St Leonards	16,738	JQZ	-	-	U/C	H2 2022
2 Blue Street	North Sydney	14,000	Thirdi Group	-	-	Site Works	2023
Macq Exchange Stage 1	Macq Park	18,000	Frasers/Winten	-	-	Site Works	2023
11 Khartoum Road, Stage 1	Macq Park	16,800	Stockland	-	-	Site Works	2023
Victoria Cross OSD	North Sydney	55,000	Lendlease	-	-	DA Approved	H2 2024
173 Pacific Highway	North Sydney	11,000	Maville Group	-	-	DA Applied	2024+
110 Walker Street	North Sydney	60,000	Stockland	-	-	DA Applied	2024+
475 Victoria Avenue	Chatswood	6,500	Blackrock/ Cromwell	Pending Pre-comm	-	DA Approved	2024+

Recent significant tenant commitments

OCCUPIER	PROPERTY	MARKET	SIZE SQM	FACE RENT $/SQM (n)	INCENTIVE	TERM YRS	START DATE
Finclear~	118 Mount Street	North Sydney	900	895	32%	5	Jan-22
Luxotica~	1 Denison	North Sydney	3,000	1,100	30%	10	Dec-21
Microbiogen~	78 Waterloo Road	Macq Park	1,217	450	28%	5	Nov-21
Invocare~	40 Mount Street	North Sydney	1,727	855	30%	5	Sep-21
SAIC Motor Aust~	100 Arthur Street	North Sydney	920	800	35%	5	Sep-21
Ality~	601 Pacific Highway	St Leonards	912	670	32.5%	3	Jun-21

Pre-commitment ^ Renewal ~Existing space *Sublease

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

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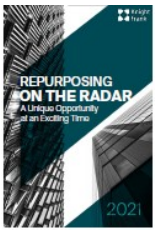

APAC Repurposing Report
2021

Outlook Report
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