

North Shore Office Market



September 2024

The structural shift of flight to quality and amenity is evident with a clear divergence in demand for best in class assets

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Key Insights

Opening of the Sydney metro and improved sentiment will aid deal flow over the second half of the year



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 **2.9%**

Premium grade vacancy

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

 **10K**

Overall net absorption

Positive net absorption in the six months to July-24 in North Sydney.

 **38%**


Elevated incentive levels

Prime grade incentives averaging 38% across the North shore markets.

 **1.7%**


Annual face rental growth

Prime net face rents average \$909/sqm in North Sydney, an increase of 1.7% y/y.

 **111bps**

Yield softening y/y

Prime yields in North Sydney softening by 111bps y/y to average 6.9% y/y.

 **\$141m**

2024 transaction volumes

Only one asset has traded in North Sydney this year. Volumes are expected to pick up by year end.

North Shore Office Market Indicators – July 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	16.5	15,366	12,501	909	35-40	6.50-7.50
North Sydney	Secondary	549,677	28.5	-5,372	-3,930	739	35-40	7.50-8.25
North Sydney	Total	941,214	23.5	9,994	8,571			
St Leonards	Prime	137,256	20.7	6,117	1,933	659	35-40	7.50-8.25
St Leonards	Secondary	222,162	30.2	-8,479	-2,139	573	35-40	8.00-8.75
St Leonards	Total	357,418	26.5	-2,362	-206			
Chatswood	Prime	129,730	25.1	-5,000	0	631	35-40	7.50-8.00
Chatswood	Secondary	141,273	16.4	241	0	520	35-40	8.00-8.50
Chatswood	Total	271,003	20.6	-4,759	0			
Macquarie Park	Prime	673,800	19.9	14,859	52,097	465	35-40	7.00-7.50
Macquarie Park	Secondary	271,549	17.8	625	0	388	35-40	8.00-8.75
Macquarie Park	Total	945,349	19.3	15,484	52,097			

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

North Sydney

STRONG DEMAND FOR BEST IN CLASS ASSETS

Tenant enquiry and deal flow has improved this year, with positive net absorption levels recorded in North Sydney for the first time in three years. This has been led by positive activity in the prime market with positive absorption of 15,366sqm recorded in the six months to July 2024. This has resulted in prime vacancy declining from 20.5% to 16.5% over the first half of the year.

The structural shift of flight to quality and amenity is significant in North Sydney as there is a clear divergence in demand for quality assets. Premium vacancy in North Sydney is tight at 2.9%. 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. With the recent opening of the Sydney metro now connecting North Sydney to Martin Place in six minutes this will only enhance the appeal and connectivity of North Sydney as an occupier destination.

MARKET WELL PLACED TO ABSORB CURRENT STOCK

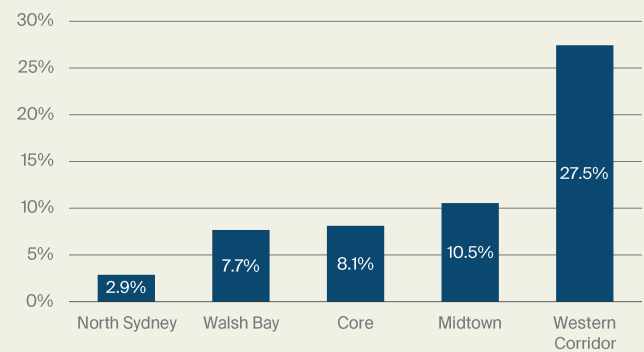
The last two developments in North Sydney were completed in 2023, including 88 Walker Street (12,501sqm) and 2-4 Blue Street. With no major developments scheduled for delivery this year the current total office stock base is 936,914sqm which is the second largest metropolitan office market in NSW; of 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.

FACE RENTS AND INCENTIVES RISE

There has been steady growth in face rents in North Sydney, with average prime net face rents increasing by 1.7% over the year to measure \$909/sqm (\$1,069/sqm gross) as at July 2024. Similarly, in the secondary market, growth has been limited to 1% over the year to currently measure \$739/sqm (\$888/sqm gross face). Incentives edged higher over the year to now average 38% which has resulted in negative net effective growth of 4.6% in the prime market to average \$503/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

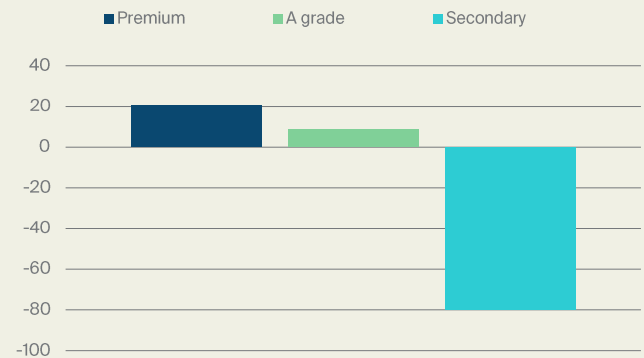
As at July 2024



Source: Knight Frank Research, PCA

North Sydney office demand by grade

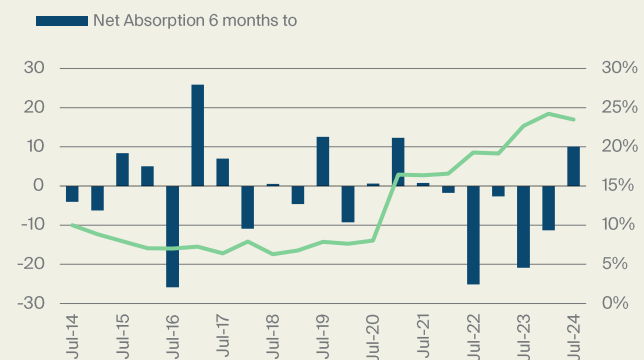
Total absorption since 2021 ('000sqm)



Source: Knight Frank Research

North Sydney vacancy and net absorption

'000 sqm, %



Source: Knight Frank Research, PCA

Macquarie Park

LOWEST VACANCY ACROSS THE NORTH SHORE MARKETS

After hitting a historical high of 20.1%, the vacancy rate in Macquarie Park eased slightly to 19.3% over the six months to July 2024 backed by positive net absorption of 15,484 sqm over the this period. Recent lease deals include Goodman Fielder taking 4,000 sqm in 118 Talavera Rd and Toshiba securing 3,200 sqm at 1 Eden St.

By building grade, prime vacancy dropped from 21.0% in January to 19.9% in July 2024, with net absorption reported at positive 14,859 sqm. Secondary vacancy decreased slightly from 18.0% to 17.8% in the first half of 2024, with positive net absorption of 625 sqm.

While the vacancy rate in Macquarie Park remains high, it sits below competing North Shore markets.

LARGEST METRO OFFICE MARKET IN NSW

The office stock in Macquarie Park totalled 945,349 sqm as at July 2024, with the refurbishment at 73 Talavera Road completed this brought 9,300 sqm back to the market. The current stock level in Macquarie Park has surpassed Parramatta and North Sydney being the largest metro office market. Additionally, with over 70% 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. Of note is 17 Khartoum Road (c.15,000 sqm) has been committed by Johnson & Johnson.

ELEVATED INCENTIVES HINDER NET EFFECTIVE RENTS

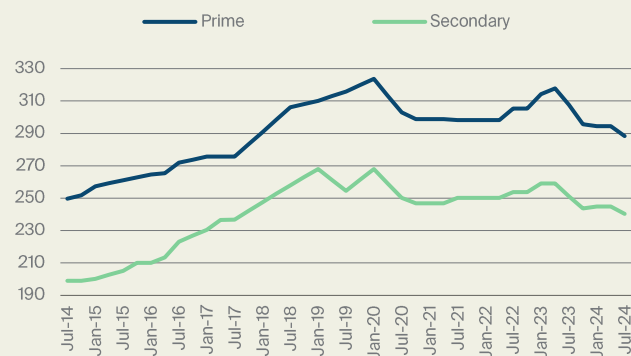
The supply influx since 2020 has added 117,000 sqm of prime space to the market and aided prime net face rental growth by 2.8% y/y to \$465/sqm (\$583/sqm gross face). Secondary net face rents increased by 3.3% y/y to \$388/sqm (\$505/sqm gross face).

Incentives have elevated from 32% in July 2023 to 38% in July 2024 given the influx of new supply, incentives now in line with other North Shore markets. Landlords in Macquarie Park are offering high incentives to retain and attract occupiers as the new developments have raised competition among prime buildings.

The uplifted incentives have offset the positive net face rental growth, with prime net effective rents declining by 6.3% to average \$288/sqm over the year to July 2024. Similarly, secondary net effective rents have declined by 4.4% y/y to average \$240/sqm.

Macquarie Park net effective rents

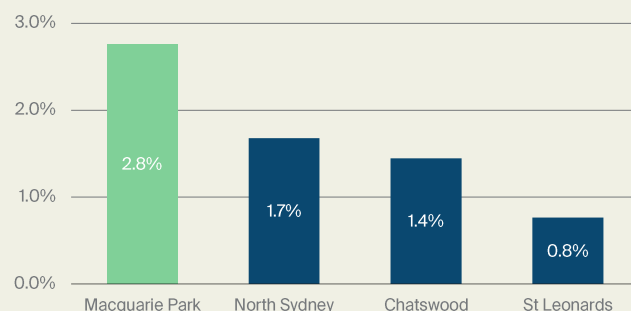
Average rent by grade, \$/sqm



Source: Knight Frank Research

North Shore office net face rental growth

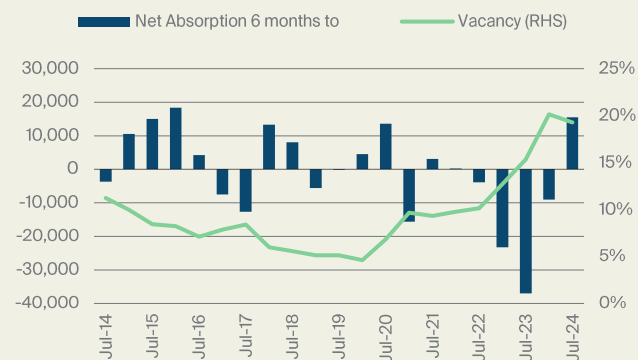
Annual growth in prime market



Source: Knight Frank Research

Macquarie Park vacancy and net absorption

sqm, %



Source: Knight Frank Research, PCA

St Leonards

VACANCY REMAINS ELEVATED

Occupier demand across St Leonards has remained relatively weak post the pandemic. The market has struggled to bounce back given increased competition across other North Shore markets and the CBD. Overall absorption over the first half of 2024 measured negative 2,362sqm, driven by a constrained secondary market. Overall vacancy has risen to its highest level on record of 26.5% as at July 2024.

By grade, the prime market has seen a decrease in vacancy in the six months to July 2024, to measure 20.7%, notably there is no prime sub-lease vacancy. Whilst overall demand is weak, the flight to quality shift is prominent with the most recent development at 558 Pacific Highway experiencing strong enquiry levels and multiple deals signed including Richard Crookes, GHD and Rural Affinity. In contrast with the secondary market, demand has been limited with negative absorption of 8,479sqm was recorded in the six months to July 2024, leading to an increase of vacancy to 30.2%, the highest level on record.

OPENING OF THE NEW METRO LIKELY TO AID DEMAND

The recent opening of the Crows Nest Metro station has significantly improved connectivity and serviceability to the area and will enhance the appeal of the precinct to occupiers. In conjunction with multiple prime grade options there will likely be strong appeal to occupiers in secondary assets to upgrade, which will likely see a greater divergence between the prime and secondary grade.

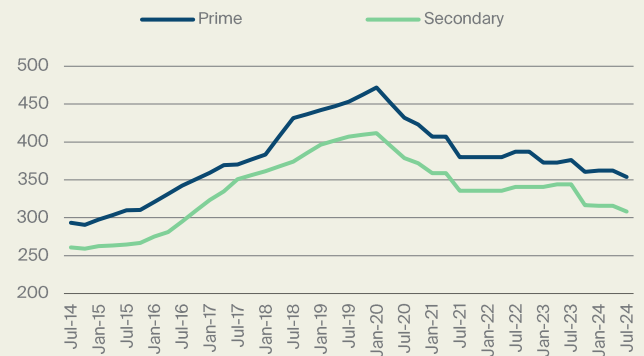
The North Shore health care precinct has established itself as one of the world class healthcare and educational hubs and is at the forefront for healthcare-related real estate as an institutional investment target. This will not only appeal to investors but also have a positive impact on demand with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

LIMITED RENTAL GROWTH COUPLED WITH A RISE IN INCENTIVES

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 (\$803/sqm gross) an increase of 0.8% over the 12 months to July 2024. Incentives have increased slightly over the year to average 38%, which has resulted in a decline of 6% for net effective rents. In the secondary market average net face rents have remained steady over the year to average \$573/sqm (\$699/sqm gross).

St Leonards office net effective rent

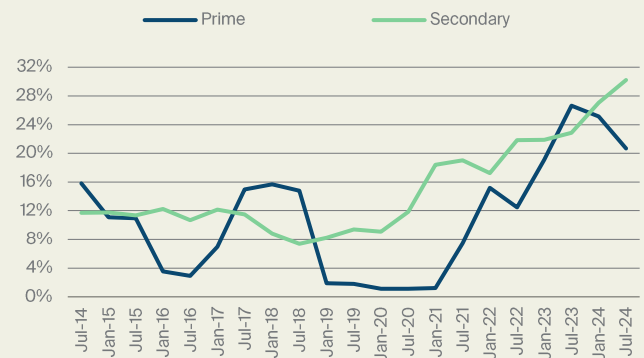
Average rent by grade, \$/sqm



Source: Knight Frank Research

St Leonards vacancy

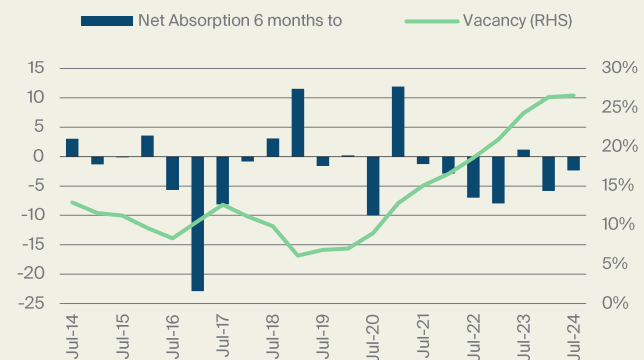
% by grade



Source: Knight Frank Research, PCA

St Leonards vacancy and net absorption

'000 sqm, %



Source: Knight Frank Research, PCA

Chatswood

TENANT RELOCATIONS AND SUBDUED DEMAND HINDER VACANCY LEVELS

Over the six months to July 2024, vacancy in Chatswood rose from 18.8% to a decade high of 20.6%. Direct vacancy was up from 17.4% to 19.6% over the same period whilst sub-lease vacancy measured 1.0% in July 2024. The rise in vacancy is attributed to the negative absorption of 4,759 sqm over the first half of the year and on an annual basis net absorption is negative 12,019 sqm.

More specifically, tenant relocations including Lenovo from 12 Help St, Chatswood to 40 Mount St, North Sydney, have largely contributed to the negative absorption levels. Additionally, Ventia has committed to Victoria Cross in North Sydney from 2025 which will see them relocate from from 475 Victoria Ave, Chatswood.

In the prime vacancy increased from 21.3% to 25.1% in six months to July 2024. Meanwhile, secondary vacancy remained steady at 16.4% in July 2024.

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.

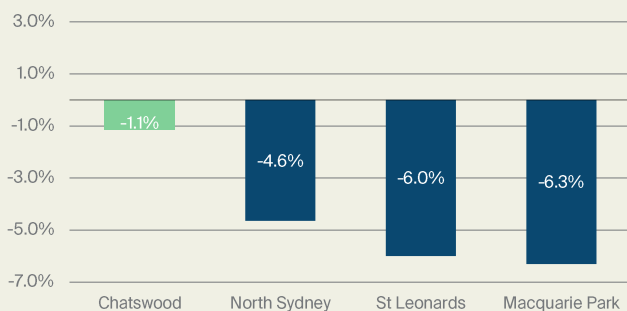
RENTS AND INCENTIVES STABILISE

Average net face rents have held flat in the first half of 2024 in Chatswood measuring \$631/sqm for prime and \$520/sqm for secondary. The current rental discount between prime and secondary sits at 18%.

Meanwhile, prime and secondary incentives have stabilised at 36% and 35% over the six months to July 2024. As a result, there has been a decrease in net effective rents by 1.1% to measure \$352/sqm for prime and 3.0% to \$293/sqm for secondary.

North Shore office net effective rental growth

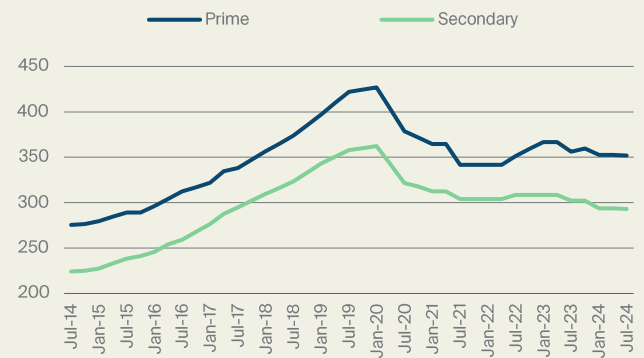
Annual growth in prime market



Source: Knight Frank Research

Chatswood net effective rents

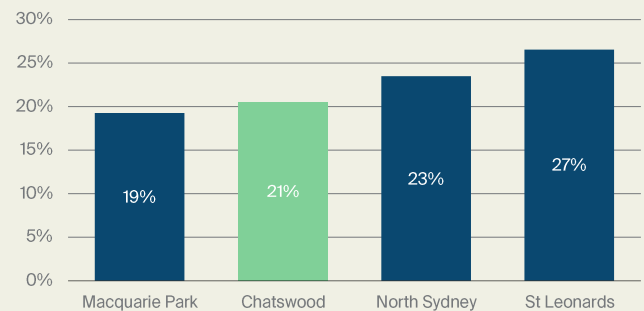
Average rent by grade, \$/sqm



Source: Knight Frank Research

North Shore office vacancy

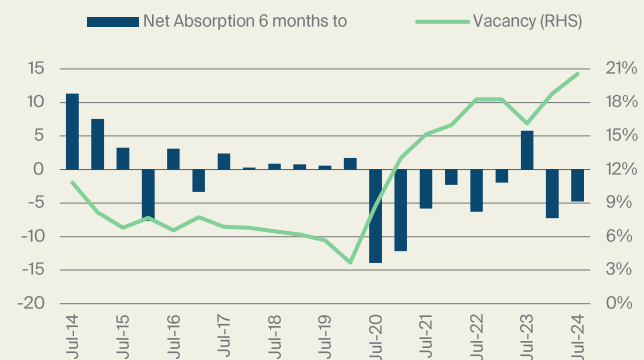
Overall vacancy, %



Source: Knight Frank Research

Chatswood vacancy and net absorption

'000sqm, %



Source: Knight Frank Research, PCA

North Shore investment

DEAL FLOW ANTICIPATED TO PICK UP

Transaction activity has been subdued since 2023 as increased debt costs and economic uncertainty has led to many investors to sit on the sidelines. The only asset to transact in the first half of 2024 is 40 Miller St, North Sydney, divested by Mirvac for \$141 million to Barings - a US-based investment manager. The sale reflected a core market yield of 7.4% and c.16% discount to its book value. Looking ahead, there are assets for sale or in due diligence stage which should see deal volumes increase over the second half of the year.

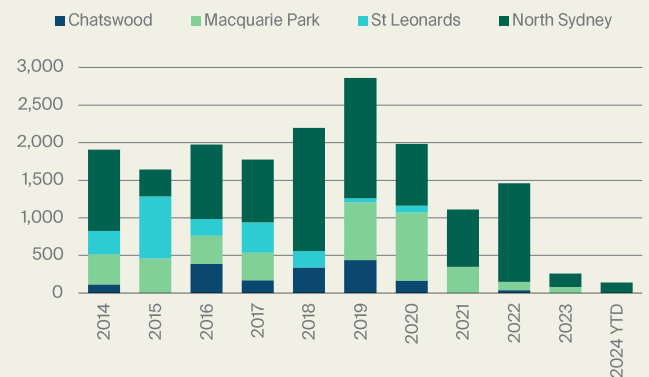
WIDENING YIELD SPREAD AGAINST CBD

The yield softening trend has continued across the North Shore markets. The average prime yield in North Sydney has expanded 111bps to 6.9% and the secondary yield moved out 63bps to 7.7% over the 12 months to July 2024. The current yield spread against the Sydney CBD is 87bps, the highest since 2017. The average prime yields across the rest of the North Shore markets currently range between 7.25% to 8.0%, while secondary yields range between 8.25% to 8.75%.

With yields being substantially reset in the North Shore markets and the macro environment becoming clearer, investment volume will start picking up as more investors return to acquisition mode and assets begin on market campaigns. The disconnect between vendor and purchaser expectations and bid spread over the last 18 months is starting to close as the fruition of declining book values comes through which will further aid deal flow.

North Shore office sales \$10m+

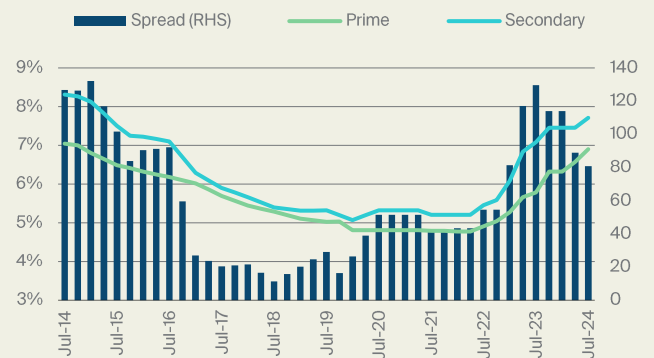
By precinct (\$m), 2014 to 2024 YTD



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
40 Miller St, North Sydney	141.0	7.4	12,615	11,177	4.1	Barings	Mirvac	Jun-24
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

Source: Knight Frank Research

Recent significant tenant commitments

Occupier	Property	Precinct	Size sqm	Face Rent \$/sqm	Incentive %	Start Date
Arthur AJ Gallagher ~	100 Arthur St	North Sydney	2,746	890	45%	Q1-25
Pandora ~	40 Mount St	North Sydney	1,209	995	36%	Q4-24
Holcim ~	100 Miller St	North Sydney	994	995	39%	Q3-24

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
M_Park Stage 2, 15&17 Khartoum Road, Macquarie Park	25,000	Stockland	U/C	2025
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.



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Recent Research



Sydney CBD Office Market Report 2024



Australian Industrial Report



Sydney City Fringe Office Market Report



Sydney Industrial State of the Market



Sydney CBD Office State of the Market



Economic Indicators report



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