

Briefing North Shore Office

June 2019



Highlights

- North Sydney A Grade and B Grade net effective rents rose 8.3% and 2.8% over the year to June 2019. Macquarie Park A Grade net effective rents grew on average by 3.8%;
- By the year 2022, over 130,000 square metres of additional stock will enter the North Shore market;
- Foreign investors were the most active buyers in the North Shore market, making up 78.0% of sales transactions;
- Sitting at 4.8%, Macquarie Park reported the lowest vacancy rate in the North Shore market, as at December 2018.

A Grade Avg. (Nth Sydney)	Latest	Yr Change	Outlook
Rental – N.F. (\$/sq m)	840	+5.0%	↗
Incentives (Net)**	22.5	-250bps	↘
Rental – N.E (\$/sq m)	650	+8.3%	↗
Yield – Market (%)	5.25	+00bps	↔
IRR (%)**	6.75	-50bps	↘
Capital Values (\$/sq m)	15,300	+10.9%	↗

Demand & Supply (Nth Sydney)	Latest	PCP*
Vacancy	6.8	6.8
Net Absorb. ('000 sq m)	-4.1	-4.1
Stock U/C ('000 sq m)	130.7	107.87
- % of market	9.4	13.3
- % committed	35	57.82

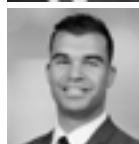
*PCP = Previous Corresponding Period
Source: Savills Research

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Executive Summary

Sydney's North Shore office markets comprise of North Sydney and Macquarie Park along with the smaller markets of Crows Nest / St Leonards and Chatswood. Whilst historically, the North Shore office market has been characterised by a higher proportion of Secondary grade stock, new developments over the last three years has seen an increase in prime grade stock, now representing over 51.7% of total stock. With Infrastructure projects coming to imminent delivery (e.g. Sydney Metro and Norwest Metro projects) Savills Research expects Office demand to increase, particularly in the North Sydney office market.

Positive investor and tenant demand in the Sydney CBD has continued its flow on effect to the North Shore office markets, particularly North Sydney. The North Shore market's leasing activity has noticed a growing number of occupiers shifting their back-end and non-client facing operations away from the CBD, taking advantage of lower rents in these markets. This has been demonstrated as the IT & Communication industry continued to dominate the leasing volumes seen in the North Shore market through the year to June 2019.

Sydney CBD's lack of available assets for sale and record high capital values has resulted in an increase of investor interest in Sydney's North Shore office markets. With similar demographics to the CBD coupled with major infrastructure projects and some of the strongest growth forecasts nationally (in relation to employment and population), the North Shore office market continues to be recognised as a viable alternative to the neighbouring CBD as an investment and occupier destination.

PCA Summary Table – North Shore including Macquarie Park (as at Dec-18)

	Prime	Secondary	Total	AUS Non-CBD
Total Stock ('000)	1,167.2	1,087.1	2,254.3	7,284.3
Total Vacancy ('000)	39.7	92.1	131.8	662.1
Vacancy (%)	3.4 (7.8)	8.5 (10.8)	5.8 (9.4)	9.1 (9.4)
Net Absorption ('000)	34.6 (14.9)	-18.1 (-3.3)	16.5 (11.6)	7.6 (37.6)
Net Absorption (%)*	3.2 (1.4)	-1.8 (-0.3)	0.8 (0.6)	0.1 (0.6)
Net Additions ('000)	0.0 (7.9)	-21.9 (-4.7)	-21.9 (3.1)	18.1 (45.4)
- Stock Additions ('000)	-	3.6	3.6	133.0
- Stock Withdrawals ('000)	0.0	25.4	25.4	114.8
Net Additions (%)**	0.0 (0.7)	-2.0 (-0.4)	-1.0 (0.1)	0.2 (0.6)

Source: Savills Research (10yr Averages shown in brackets; NB: Secondary Rents shown are for B grade; All rents equivalent to whole floor mid-rise

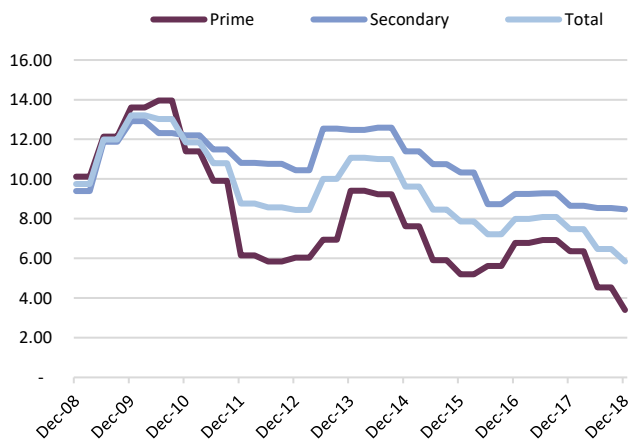
*As a percentage of occupied stock; **As a percentage of total stock

Vacancy

The total vacancy rate in the North Shore office market fell to a record low of 5.9% in December 2018, down from 7.5% in the year prior. Macquarie Park recorded the lowest vacancy rate in this period at 4.8%, with North Sydney falling to 6.8%.

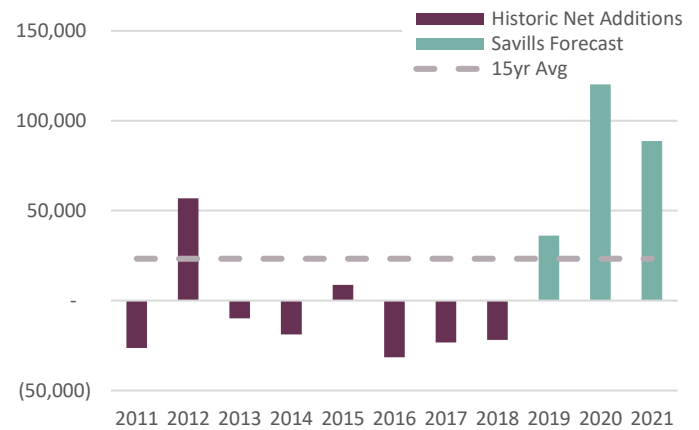
Throughout 2019, Savills Research expects vacancy rates for the North Shore market to gradually tighten. Even though the new wave of supply is opening to the market (mostly in North Sydney) in 2020, much of this supply has already been pre-committed.

Historic Vacancy (North Shore inc. Macquarie Park)



Source: Savills Research

Net Supply by Year (North Shore inc. Macquarie Park)



Source: Savills Research

Supply

Recently, Dexus' 100 Mount Street in North Sydney reached practical completion, adding circa 40,000 square metres of office space into the North Shore market.

Supply will come on line from 2020 with 1 Denison Street, 45 Waterloo Rd and 118 Mount Street. These projects are expected to introduce over 127,000 square metres of new office supply.

Of the new supply, Savills Research believes approximately 35% has been pre-committed and is expected to be fully committed upon practical completion from late 2020.

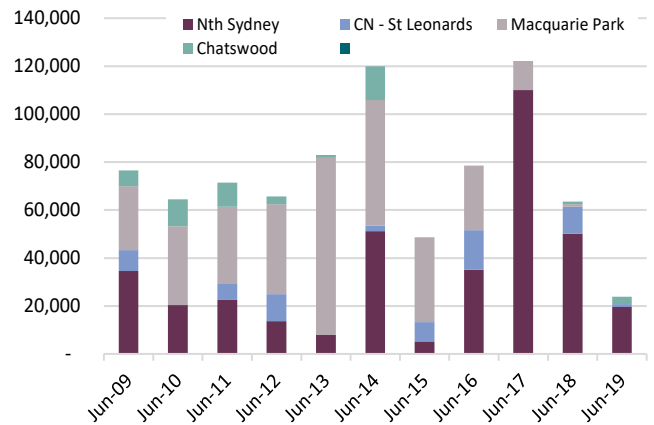
Leasing Activity & Demand

In the 12 months to June 2019, Savills Research recorded over 23,000 square metres of leasing activity in Sydney's North Shore (> 1,000 square metres) versus the prior 12 month period (~65,000 square metres) and circa 69.3% below the five year average. Savills Research believe the lack of leasing transactions are not reflective of reduced demand in the North Shore, but merely a shortage in available Prime stock, particularly in North Sydney and Macquarie Park, as both are awaiting the addition to stock in 2022.

The majority of transactions (> 1,000 square metres) in the 12 months to June 2019 made in North Sydney, which accounted for approximately 88.0% of total leasing volumes. 'IT & Communication' sectors represented over 46.0% of total leasing volumes in the year to June 2019, followed by the 'Property & Business Services' sector at 38.0%.

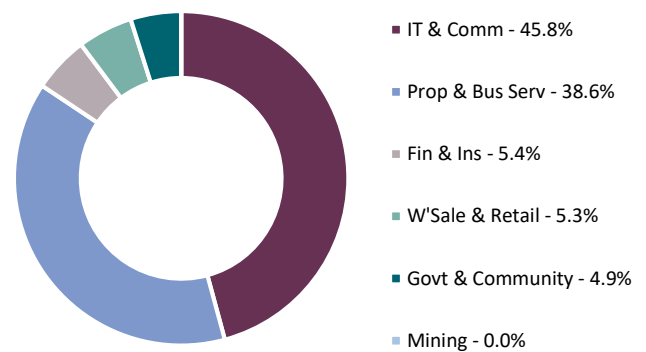
The continuation of demographic drivers coupled with infrastructure projects, once complete, will contribute to increased tenant demand. As co-working groups enter Sydney fringe markets, they will be able to fuel the pent up demand for smaller tenants radiating from the Sydney CBD with available co-working space, predominantly for back-end and non-client facing occupier types. WeWork's 4,100 square metre lease at 50 Miller St, North Sydney suggests the trend. Recent development applications such as Maville Group's 173 Pacific Highway, North Sydney are dedicating nearly 20.0% of total NLA to co-working, small business and start-ups.

Leasing Activity by Precinct (> 1,000 square metres)



Source: Savills Research

Leasing Activity by Tenant Type (> 1,000 square metres)



Source: Savills Research

Recent Notable Leases (by Area Leased)

Property	Tenant	Date NLA (sq m)	Type Rent Term
111 Pacific Highway, North Sydney	Nokia Solutions and Networks	Sep-18 4,880	Direct 715 (N) 5
100 Arthur St, North Sydney	Equifax Australasia Group Services	Dec-18 4,123	Renewal 810 (N) 5
50 Miller St, North Sydney	WeWork	Nov-18 4,100	Direct n.a 12
821 Pacific Highway, Chatswood	McCabe Curwood	Jan-19 1,894	Direct 620 (N) 8
100 Pacific Hwy, North Sydney	Random House Australia	Feb-19 1,807	Renewal 735 (N) 7
101 Miller St, North Sydney	Experian	Sep-18 1,381	Direct 850 (N) 5
207 Pacific Highway, St Leonards	Only About Children	Jul-18 1,300	Direct 645 (N) 7
100 Pacific Hwy, North Sydney	Mortgage Choice	Oct-18 1,221	Renewal 770 (N) 5
475-501 Victoria Ave, Chatswood	Primary Health Network	Nov-18 1,100	Direct 524 (N) 6

Source: Savills Research

Sales

Savills Research recorded over \$1.97 billion of office transactions (greater than \$5 million) in the 12 months to June 2019 across the North Shore market. This is an increase of 34.0%, respectively, from the year prior, and notably higher than the 10 year average. This is due to noteworthy transactions (> \$100 million) during 2019, such as; 821 Pacific Highway, Chatswood, 111 Pacific Highway, North Sydney and 11 Talavera Road, Macquarie Park.

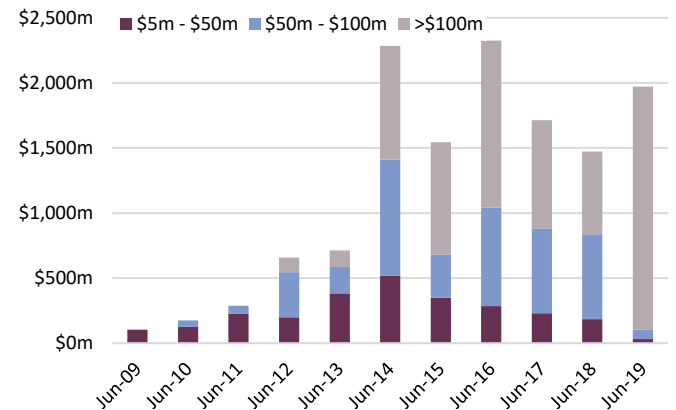
The majority of North Shore transactions were made in North Sydney and Chatswood precincts. Combined, the two precincts accounted for approximately 80.0% of total sales volumes in the 12 months to June 2019.

Foreign Investors dominated as the most active purchasers in through the year to June 2019, accounting for 78.0% of total sales volumes. Savills Research expects to see a continual shift in demand toward the North Shore, as CBD prices relatively lift this market with investors in search of higher yielding assets. Starwood Capital Group and Arrow Capital Partners were responsible for the largest Foreign Investor transaction in the North Shore market throughout the year to June 2019 with the acquisition of the Zenith Centre, located at 821 Pacific Highway for \$438.2 million.

A Grade assets transacted heavily through the year, amounting to 85% of total transactions to June 2019, with Secondary assets accounting for over 15% of all office assets transacted (> \$5 million) in the market. While Secondary grade transactions have slowed from previous years, signs of investor appetite remain for assets with future re-development potential, such as the B Grade sale of 80 Mount Street, North Sydney which sold to Hong Kong investor, CKK Enterprises for \$71 million.

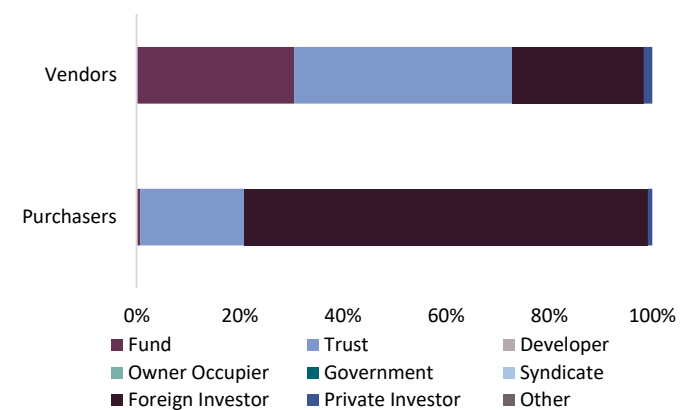
As at June 2019, A Grade market yields in North Sydney ranged from 5.00% to 5.50%, whilst B Grade market yields ranged from 5.50% to 6.00%, resulting in no change over a 12 month period. Similarly, Macquarie Park saw no change in market yields in the 12 months to June 2019, with A Grade yields ranging from 5.50% to 6.00% over the same 12 month period. Average capital values in North Sydney increased by 8.3% over the year to June 2019. Macquarie Park, however, witnessed no change to capital values over the same period.

Sales Activity by Precinct (>\$5 million)



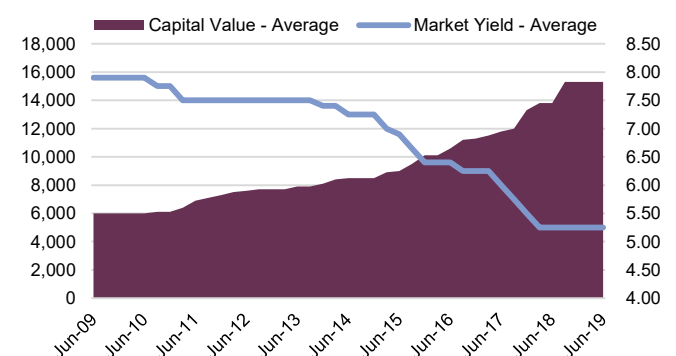
Source: Savills Research

Vendor & Purchaser Type



Source: Savills Research

Capital Values (\$/sq m) vs. Market Yields



Source: Savills Research

Recent Notable Sales (by Sale Price)

Property	Price (\$m) Date NLA (sq m)	Yield Type \$/sq m
821 Pacific Hwy, Chatswood	438.20 Jun-19 44,102	6.21 i 9,936
111 Pacific Hwy, North Sydney	275.00 May-19 18,668	5.12 i 14,731
11 Talavera Rd, Macquarie Park	231.20 (Net) Feb-19 35,830	4.81 i 6,453
40 Mount St, North Sydney (50.0%)	226.50 Dec-18 28,552	5.18 e 15,866
100 Miller St, North Sydney (50.0%)	215.00 Aug-18 26,965	4.10 i 15,906
465 Victoria Ave, Chatswood	166.50 Oct-18 15,639	5.74 e 10,646
67 Albert Ave, Chatswood	158.00 Nov-18 14,756	5.82 e 10,708
72 Christie St, St Leonards	157.55 Dec-18 11,259	5.08 e 13,993
77 Pacific Hwy, North Sydney	112.35 May-18 9,392	5.36 e 11,962
80 Mount St, North Sydney	71.00 Sep-18 6,204	5.46 e 11,444

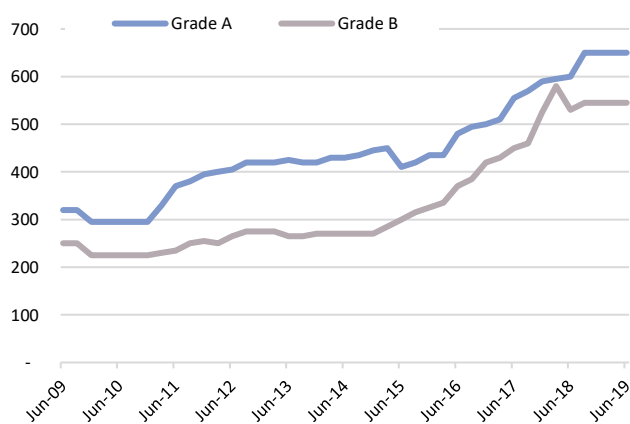
Source: Savills Research; Yield Types: i = Initial, r = Reported, e = Equated, v = Vacant, dev = development

Rents

The 12 months to June 2019 saw continual growth in markets across the North Shore. North Sydney, in particular, is increasingly being viewed as a viable alternative to the CBD. Average A Grade net face rents recorded at \$840 per square metre, flat for the quarter, however, grew 5.0% over the 12 month period. Average B Grade net face rents grew to \$725 per square metre over the same period, reflecting a growth rate of 3.75%. On a net effective basis, North Sydney’s A Grade buildings recorded a rental growth rate at 8.33%, reaching \$650 per square metre as at June 2019. Average B Grade effective rents grew to \$545 per square metre, increasing by 2.83% over the same period.

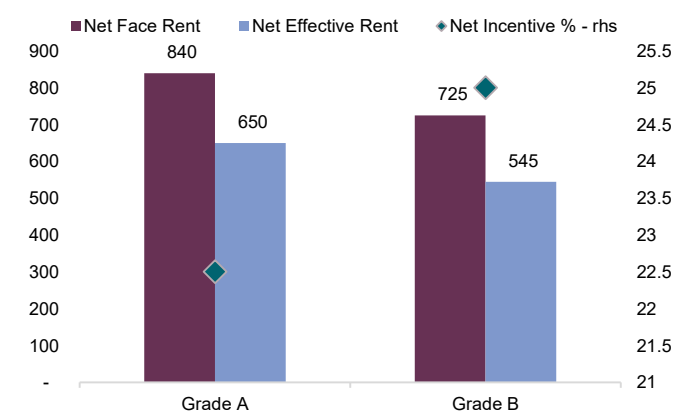
Net face rents for A Grade buildings in Macquarie Park averaged at \$370 per square metre, growing 2.78% over a 12 month, whereas net effective rent increased to \$270 per square metre, rising by 3.85% through the year to June 2019.

Net Effective Rents by Grade (\$/sq m) – Nth Sydney



Source: Savills Research

Net Face & Net Effective Rents (as at Jun-19) – Nth Sydney



Source: Savills Research

Outlook

Savills Research expects that vacancy constraints and increasing rents in the Sydney CBD will shift tenant demand to the North Shore office markets over the short to medium term. The completion of infrastructure projects such as the new Metro railway line, will improve accessibility and travel time into the North Shore line from north-west suburbs. Looking forward, the construction of the additional railway station at North Sydney (Victoria Cross) will also be a positive demand driver for North Sydney once complete in 2023/2024.

Savills Research expects North Shore markets to benefit from the NSW Government plans to diversify their presence between 2018 and 2020, requiring the delivery of over 140,000 square metres of open, flexible and collaborative office space across metropolitan and regional locations for their employees. Savills Research anticipates an increase to pre-commitment leasing volumes in the Government & Community sector.

In addition, planning reforms are in action to address the North Shore commercial market's demand over the coming years. Near term supply is limited, with tenants expanding their presence pushing demand.

Development

The table below summarises some of the major upcoming and planned development projects in the North Shore office market.

Building Address	Dev Stage	NLA	Exp. Comp	Precinct	Tenants
18-20 Atchison Street	PA	2,362	2020	Crows Nest - St Leonards	
472-486 Pacific Highway	UC	3,695	2020	Crows Nest - St Leonards	
1 Denison St	UC	66,707	2020	North Sydney	Nine Entertainment, SAP
95 Waterloo Road	PS	14,874	2020	Macquarie Park	
45 Waterloo Road (Building C)	UC	37,680	2020	Macquarie Park	NSW Government
118 Mount St	UC	22,694	2021	North Sydney	Zurich
11 Talavera Road	PS	26,000	2022	Macquarie Park	
8-12 University Avenue	DA	50,000	2022	Macquarie Park	
Cnr Miller St & Berry St	EP	60,000	2023	North Sydney	
173 Pacific Hwy	PS	11,000	2024	North Sydney	
31-35 Epping Road	PA	14,477	2025	Macquarie Park	
396 Lane Cove Road	PS	80,000	2025	Macquarie Park	
Lot 8 Julius Avenue (Incl Lot 9)	PS	34,194	2025	Macquarie Park	

Source: Savills Research; UC = Under Construction; DA = Development Approved; PS = Plans Submitted; EP = Early Planning

North Shore Key Indicators (Q2-19)

North Shore	North Sydney				Macquarie Park	
	A Grade		B Grade		A Grade	
	Low	High	Low	High	Low	High
Rental - Gross Face (\$/sq m)	915	1,040	805	905	435	535
Rental - Net Face (\$/sq m)	775	900	675	775	320	420
Incentive Level - Net (%)	20%	25%	20%	30%	25%	30%
Rental - Net Effective (\$/sq m)	600	700	505	580	230	305
Outgoings - Operating (\$/sq m)	90	110	80	100	65	85
Outgoings - Statutory (\$/sq m)	35	40	35	40	35	45
Outgoings - Total (\$/sq m)	125	150	115	140	100	130
Typical Lease Term (years)	7	10	3	7	5	8
Yield - Market (%)	5.00	5.50	5.50	6.00	5.50	6.00
IRR (%)	6.63	7.00	7.00	7.50	6.75	7.25
Cars Permanent Reserved (\$/pcm)	550	700	475	550	225	275
Office Capital Values (\$/sq m)	13,000	17,500	11,000	12,500	6,500	7,500

Source: Savills Research NB: All rents equivalent to whole floor mid-rise

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