CI AUSTRALIA

OFFICE MARKET UPDATE

SYDNEY'S NORTH SHORE

OCTOBER 2018

CI

EXECUTIVE SUMMARY.

Welcome to our October 2018 Office Market Update. We explore supply, investment and development, market trends and more across Sydney's North Shore.

A number of themes are in play and shaping the way in which both investors and tenants are viewing the market, and the opportunities available to them.

The first is the flow-on effect from the strength of Sydney CBD market that North Sydney in particular remains a beneficiary of. An increase in investment and occupier demand coupled with record low vacancy has created conditions for the market to continue forging ahead.

The second is the rise of mixed-use developments on the North Shore; which of course reflects the broader trend playing out across Sydney CBD and nationally. The 2019 completion of the North West Metro Line will continue to see investors and developers take advantage of these new opportunities, to offer spaces where people can live, work and play.

The third is co-working, and how we believe the discourse should shift from the impact it's having on the traditional leasing market and model, to how we move forward together and achieve the best results .

We hope you find this report interesting and a useful reference tool. All data quoted is either CI Australia Research, RCA Analytics or Research from the Property Council of Australia (August 2018 Data Release).

If you have any questions or would like to request bespoke research or investment analysis, we'd be delighted to speak with you.

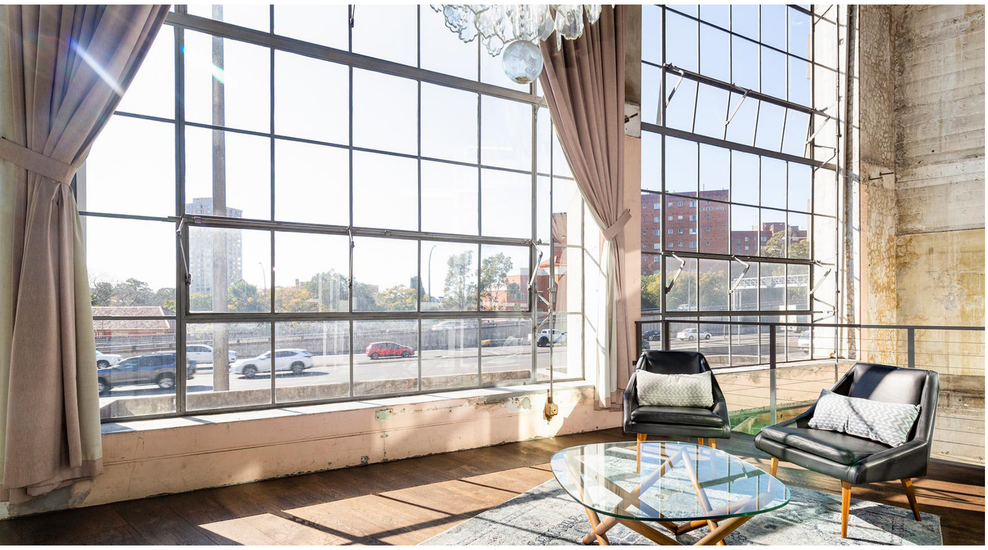
Bevan Kenny

MANAGING DIRECTOR, NORTH SYDNEY

Equality of space and style?

The desire to provide office spaces where people can thrive has fundamentally changed the way we build, operate and interact with our workplaces and our cities.

So while coworking is deservedly popular, perhaps it's just as important to ensure we continue nurturing a diversity of working styles and fitouts that suit the workforce they serve, writes CI's Associate Director of Leasing, Anthony Merrett.



Above: Work inc at Sydney's Lavender Bay
Source: workinc.com.au

It has been reported that coworking spaces have increased in Australia by 62% since 2017. This rapid growth reflects the diverse nature and continued generational change of today's workforce. And it is predicted that by 2030, 75% of the workforce will be comprised of Generation Z and Millennial employees. These generations crave dynamic, flexible and tech-enabled working environments that reflect the changing ways in which we now work, live and play, that were unprecedented some 5-10 years ago.

We know that coworking fosters innovation – a major growth engine of Australia's successful economy and business markets – with many coworking spaces dominated by entrepreneurs who are motivated to share their expertise and work closely with like-minded professionals.

There's no denying that the continued growth of coworking has challenged the conventional commercial office, in both form and function. One change we've seen is the reduction of space ratios required in coworking spaces. Occupancy for one person can be as low as 6sqm, whereas in a typical office space, it is one person to every 10sqm - 15sqm. Given coworking spaces are now a very real part of many commercial buildings across Sydney, landlords have had to modify their buildings to cater for this increased density; including ensuring sufficient amenities, lift and fire services and more resilient and capable heating and cooling systems.

A key benefit for businesses of coworking is the flexibility of both space and term, which the traditional commercial lease, typically offering three-year terms, has not been able to compete with. Another way coworking has challenged the leasing market is the reduction in demand for smaller serviced office suites – ones that were initially designed by landlords with these very start-ups or growing businesses in mind. And when there's significant capital to be saved for tenants through fitout and cost amortisation, through shared service costs such as printing, phone and internet connections, board rooms, break out spaces and more, it's clear to why the model has gained pace.

While this has and is continuing to create some tension between coworking operators and landlords, many landlords are championing innovation to take advantage of this changing market.

Some are building dedicated floors and in fact, entire assets specifically designed to attract the typical ‘coworking tenant’ directly into their buildings. We’ve seen this unfold with Dexus’ exciting SuiteX initiative; the evolution and extension of its highly successful Dexus Place offering that first launched in 2015.

Just as the ever-popular Uber has evolved and adapted since its introduction, most recently with the launch of ride sharing option UberPool, so too has coworking since its launch into the market. New players have entered and created competition and fragmentation beyond the global giants such as WeWork. This has given tenants more choice of their provider and in some instances, afforded negotiations on rental terms. Coworking is also no longer just for small businesses either – larger corporations are utilising it during times of growth, for project/temporary space including at times of unforeseen growth, as are those looking to provide an alternative to their fixed space for employees.

And at the same time, some coworking operators who are aware of the demand for their offering and keen to capitalise on it are changing tact and looking to become office investors – no longer just tenants – a move which brings with it its own set of implications for the investment market.

However, the wider and perhaps more ‘traditional’ aspects of market have also, and will continue to, evolve organically. Buildings must foster the health and wellbeing of their occupants and this is commonplace nowadays with designs and concepts such as ‘bringing the outdoors in’ with greenery, standing desks, quiet zones and more. Companies are finding through trial and error what types of fitouts and space arrangements work for them, whether it’s the successful adoption of Activity-Based Working, a mix between fixed and coworking space, or the creation of a bespoke design that reflects the needs their workforce, whether it be set desks with more collaborative areas, or a higher percentage of quiet rooms depending on needs and business aims.

Coworking is a natural development in today’s fast-paced world and a reflection of the successful sharing and trade economy that not only Uber but the likes of Gumtree, Airtasker and GoGet have built a business off. So while its prominence has been a challenge in some ways for the more conventional office space, perhaps the future is more about embracing all different types of office models as equal, and adapting to new ways of working, together.

ANTHONY MERRETT

ASSOCIATE DIRECTOR, LEASING

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>
> The market has and will continue to evolve organically, as businesses and societies adapt to an increasingly tech-enabled world.

NORTH SYDNEY

ALIVE WITH **ACTIVITY.**

With just 6.3% vacancy as of July 2018, space in North Sydney is tight - in fact, the tightest it has been since 2001. A Grade vacancy sits at only 2.2%. The largest vacancy at present in the market is 100 Arthur Street, with 20,000sqm becoming available.

Transactions to have taken place in A Grade space in the First Half of 2018 are as follows:

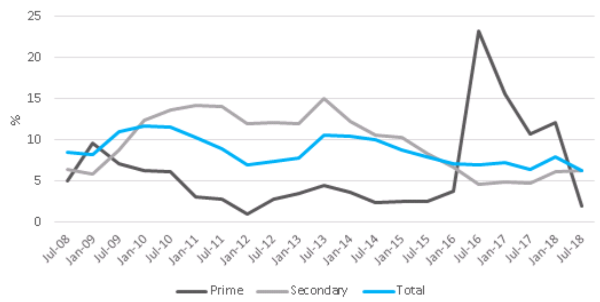
- 80 Pacific Hwy – Open Text (2017sqm)
- 100 Pacific Hwy– Reckon (1808sqm)
- 100 Arthur Street – Fetch TV (1370sqm)
- 111 Pacific Highway – Nokia (4,880sqm)

Pre commitments to new developments remain strong. SAP has secured 5,682sqm at 1 Denison, with strong interest for the remaining 100 Mount Street vacancy. Amenity for tenants will be plentiful with three new restaurants set to open at Northpoint, 100 Miller St too - Green Moustache (506sqm), The Grounds (464sqm), and Japanese restaurant Ginza (308sqm).

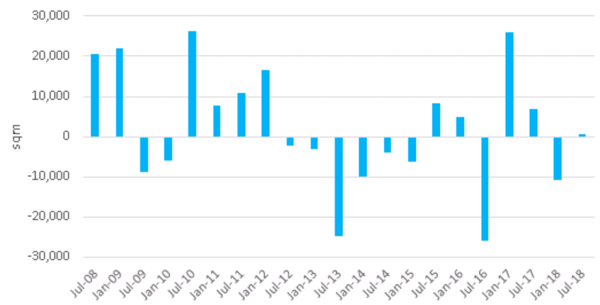
13,552sqm of withdrawals were recorded in the six months to July 2018. This accounted for 95% of all the withdrawals on the North Shore. Combined with no new supply, these factors have driven rent higher and incentives down. A/Premium Grade gross rents were at $878 per sqm per annum, with B Grade at $743 per sqm per annum. Incentives meanwhile for A/Premium Grade were at 22-30% and for B Grade, at 17.5-22% Gross.

Tenant relocation from the Sydney CBD has and will continue to become more prevalent, consecutively pushing vacancy lower and driving up rents.

VACANCY RATE



NET ABSORPTION 6 MONTHS



INVESTMENT & **CAPITAL FLOWS.**

North Sydney properties remain as an attractive investment alternative and for some, complementary to the Sydney CBD. The pricing differential, close proximity to CBD, high rental growth and competitive yield are key factors that have and continue to keep buyers motivated from both domestic and offshore sources.

In fact, of all the total four office assets purchased by overseas investors on the North Shore in the First Half 2018, all occurred in the North Sydney Market. Not only does this demonstrate the pull of investment to North Sydney, but the decreased stock levels across the broader North Shore market that have and continue to be evident across broader Sydney. Evidencing the stock restrictions further are the lowered transaction levels; 10 North Shore assets changed hands in the period to June 2018, with 60% of them in North Sydney. This compares to 16 transactions in the same period in 2017.

Meanwhile, North Sydney yield continues to drop, and is expected to consolidate at mid 4% as evidenced in the recent sale transactions. The 1,985sqm asset at 123 Walker St was sold at a cap rate of c4.6% in April 2018 to One Smarter Pty Ltd, and more recently, Early Light International Group purchased a half stake in the $600m asset at 100 Miller Street at c4.7%.

The next five years will see numerous office, residential and retail developments complete in anticipation of the opening of the Sydney Metro in 2024. Preparations are under way to sell the air rights above the station where a 65,000sqm + Over Station Development (OSD) is envisaged, comprising office and retail space.

Both domestic and offshore commercial investors understand the investment proposition of North Sydney, which is being led by developments as outlined below. These key projects will be knitted together by the Central Laneways Precinct, a pedestrianised retail and public domain area that will facilitate interaction and movements throughout North Sydney.

1 Denison Street - A 60,000sqm Premium Grade office tower will dominate the North Sydney Skyline and deliver a vibrant street level experience for the community, including Channel 9's live television studios.

100 Mount Street - Construction of this 35-level 40,000sqm Premium Grade office tower is well advanced, with approximately 60% pre-committed.

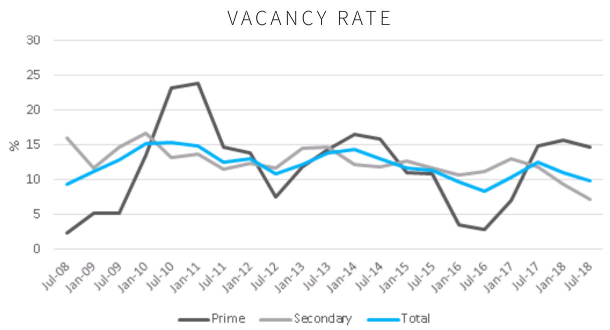
118 Mount Street - The development of Zurich Financial Services Australia's new country headquarters commenced in May 2018, and will deliver a new 25-story commercial tower.

88 Walker Street - Plans lodged for a $121 million, 35-storey hotel and commercial tower by developer Billbergia. The plans aim to utilise the air space above the heritage 'Firehouse Hotel' currently on the site.

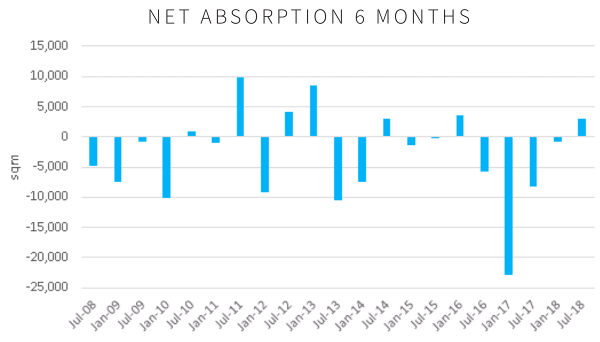
ST LEONARDS & CROWS NEST

RISING AMENITY.

Vacancy rate has dropped from 11.1% to 9.9% as at June 2018. This will go down further with MasterCard leasing 12,000sqm at 72 Christie Street. The largest vacancy will be within 120 Pacific Highway (5,130sqm) when Clemenger relocates to Walsh Bay. This move will locate the advertising firm closer to the city, to many of its clients and to the agency hub in and around Hickson Road and Windmill Street, which is home to Publicis Groupe, Dentsu and WPP's HQ on Kent Street. Meanwhile, Virgin Active secured 1,150sqm at 472 – 486 Pacific Highway. Stock levels remain low, particularly for smaller suits < 300sqm, and some tenants have reported difficulties in finding properties without demolition clauses. Incentives for B Grade 15-20% Gross, and A Grade at 22-28%.



Source: PCA/CI



Source: PCA/CI

INVESTMENT & **CAPITAL FLOWS.**

Two key assets transacted in the first half of 2018. A half stake was acquired in 201 Pacific Highway, St Leonards by Lederer Group and Centuria; from Abacus and Goldman Sachs at an approximately 6.5% yield. The property is located above the St Leonards Railway Station.

The fully leased office asset at 154 Pacific Highway sold for $60 million in July at a passing yield of c.5.9%, in a deal brokered by CI Australia.

Meanwhile, two key mixed-use developments will push the further development of the market.

ST LEONARDS SQUARE

The retail and commercial space at St Leonards Square (472 – 486 Pacific Highway) will comprise about 7500 square metres, with office space accounting for 4300 square metres. The two-tower development, which is being developed by Mirvac, is expected to provide further amenity including strata suites to St Leonards, which is respected as one of Sydney's key employment precincts.

88 CHRISTIE STREET

A $1.6 billion development by JQZ encompassing a 15-storey office tower, a 26-storey luxury apartment tower and retail space. 'Eighty Eight' will also see the addition of a new 780sqm public plaza built over the existing rail line; a new public library; and a major supermarket which will form part of the multi-storey retail and dining precinct.

Top image: An impression of 'Eighty Eight' Christie Street, St Leonards. Source: https://88byjqz.com.au/

CHATSWOOD

VACANCY DIPS IN THE **ORIGINAL MIXED-USE PRECINCT.**

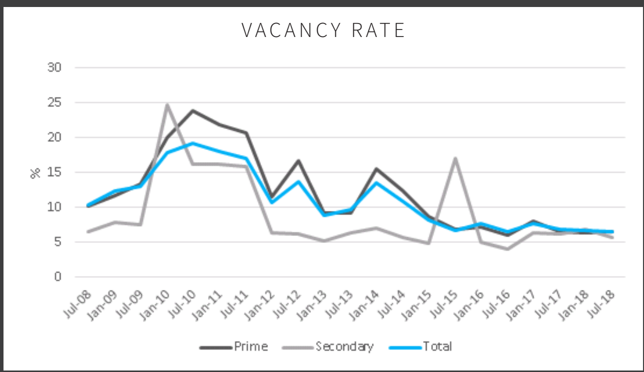
Vacancy rate as of July 2018 sits at 6.5% - the lowest it has been since 2007. Incentives in B Grade space are 15-20% Gross, with A Grade incentives at 17-25%.

A large number of high profile tenant migrations to Chatswood have taken place, and it is possible this will continue. Chatswood's strong amenity and transport links provides accessibility from not only the Sydney CBD but also the Central Coast and is often cited in major tenant relocations, as it provides access and exceptional facilities to a more diverse workforce. Only one major leasing deal was struck in the first half of 2018, with McCabe Curwood committing to 1,870sqm in 821 Pacific Highway.

INVESTMENT & **CAPITAL FLOWS.**

The key investment move in the first half of 2018 was Chinese private equity group iProsperity purchasing the stake in the asset of 1-5 Railway Street from Hume Partners for $107 million in March, at a passing yield of c.7.1%. CI acted on behalf of the vendor.

It is expected that investment demand will remain strong for Chatswood office assets. As one of Sydney's most mature and successful mixed-use precincts, its major public transport junction, comprehensive retail offerings and vibrant local cultural scene continue to draw interest and demand from residents, consumers, knowledge workers and commercial tenants.



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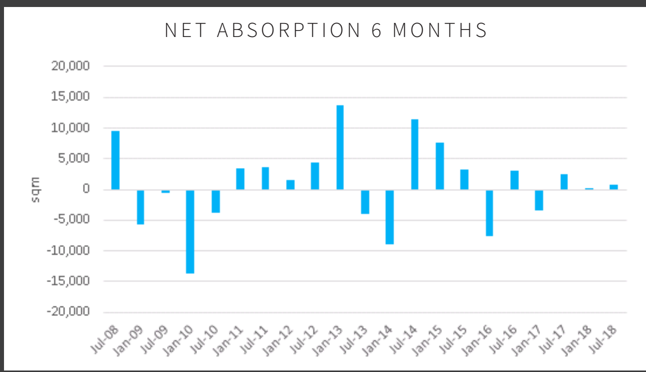


Source: PCA/CI

RECENT LEASING TRANSACTIONS - MOVING TO CHATSWOOD

Tenant	Area (sqm)	Moved to	Relocated from
Toll	1,800	475 Victoria Avenue, Chatswood	Thornleigh
Carnival	3,500	465 Victoria Avenue, Chatswood	North Sydney
CMC Markets	1,100	67 Albert Avenue, Chatswood	North Sydney – Disaster recovery office
Dupoint	900	67 Albert Avenue, Chatswood	Macquarie Park

Source: CI

MACQUARIE PARK & NORTH RYDE

TAKING **SHAPE.**

Vacancy in Macquarie Park is sitting at a record low of 6%. This is primarily due to the fact that circa 13,000sqm has been withdrawn due to residential development.

This has led to limited opportunities for commercial tenants. A Grade rents are sitting between $310-$390psm net, with incentives for A Grade stock ranging from 20-24% and B Grade is 25-28%.

The new Metro Station will connect Macquarie Park directly to Chatswood, North Sydney, Barangaroo and Martin Place, and is expected to improve attraction from tenants and investors.

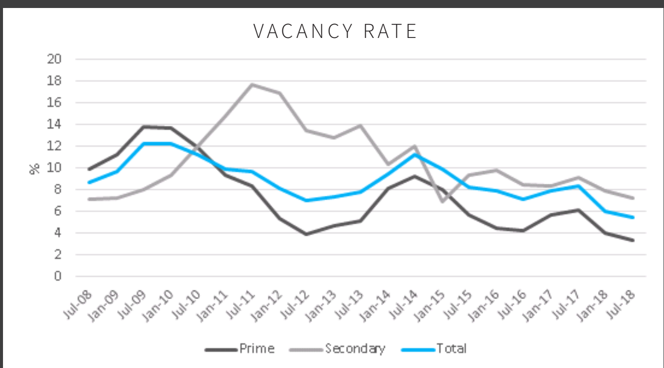
INVESTMENT & **CAPITAL FLOWS.**

Much of the investment into the area has not been to commercial assets, but to new residential developments and improving transport and amenity.

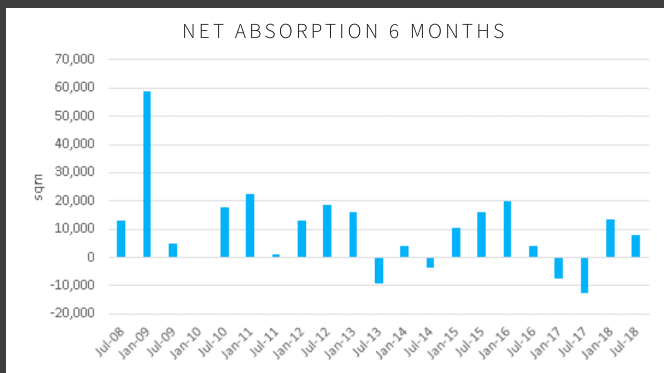
The John Holland development at 43-61 Waterloo Road, Macquarie Park, due to completion in 2020, will add an additional 100,000sqm of A Grade office space to the market. NSW Transport is an anchor tenant and has pre-committed to 25,000sqm.

Meanwhile, Winten Property Group has concept plan approval for approximately 70,000sqm of A Grade office and retail space in its new business precinct (Macquarie Park Commerce Centre) at 36-42 Waterloo Road. This site will be directly above the new Macquarie Park Metro Station.

More broadly, The Department of Planning and Environment is working closely with City of Ryde Council and Transport for NSW to develop new plans for Macquarie Park. This will aim to identify opportunities to enhance the area's existing role as a major commercial centre and innovation district. This will also include investigating opportunities for securing the commercial future of Macquarie Park.



Source: PCA/CI



Source: PCA/CI

RECENT LEASING TRANSACTIONS

Tenant Name	Property Address	Area m^2	Lease Start Date	Net Rental $/m²	Outgoings $m²	Reviews %	Lease Term (years)	Net Incentive %
NuVasive	2-4 Lyonpark Road, Macquarie Park	592	Jun-18	370	99.36	3.50	5	25
Nokia	16 Giffnock Road Macquarie Park	1145.5	Apr-18	310	90.56	3.50	5	25
John Holland Group	35-41 Waterloo Road Macquarie Park	332	Feb-18	315	101.00	3.75	2	20
Enviro Pacific	123 Epping Road, Macquarie Park	681	Apr-18	325	82.00	3.00	5	27
Reckitt Benckiser	10A Julius Avenue, North Ryde	600	Dec-17	330	95.00	3.50	10	28
Sealed Air Australia	5 Eden Park, Macquarie Park	613	Jul-18	360	62.82	3.50	5	28
Cardinal Health	5 Eden Park, Macquarie Park	360	Mar-18	360	62.82	3.50	5	U/D

Source: CI

NORTH SHORE ACTIVITY

RECENT SALE TRANSACTIONS

Date	Suburb	Address	NLA (sqm)	Price (A$)	$/sqm	Cap Rate	Owner/Buyer	Seller
May-18	Chatswood	27 Albert Ave	870	14,180,000	16,299	N/A	27 Albert Avenue Pty Ltd	Develotek Property Group
Mar-18	Chatswood	1-5 Railway Sq	18,247	107,000,000	5,864	7.1%	IProsperity	Taverners Value Funds
Sep-18	North Sydney	80 Mount St	6,204	71,000,000	11,445	4.3%	Hong Kong investor	Goldman Sachs, Property Link
Jun-18	North Sydney	88-92 Walker St	3,064	32,250,000	10,526	N/A	Billbergia Group	Marprop Development
Apr-18	North Sydney	100 Miller St	31,694	300,000,000	16,250	4.7%	Early Light International	Redefine Global (REIT)
May-18	North Sydney	77 Pacific Hwy	9,379	112,340,000	11,978	5.4%	U/D	Stockland
May-18	North Sydney	54 Miller St	7,056	59,400,000	8,419	5.0%	AEW Capital	Aqualand Projects
Apr-18	North Sydney	123 Walker St	1,989	21,300,000	10,709	4.6%	One Smarter Pty Ltd	Restifa
Jan-18	North Sydney	157 Walker St	8,928	79,050,000	8,854	6.1%	GLL RE Partners, Marprop Development	Epsom Nominees Pty Ltd & M Arch Nominees Pty Ltd
May-18	Crows Nest/ St Leonards	154 Pacific Hwy	6,427	60,200,000	9,367	5.9%	NSW Farmers Association	Property Bank Australia, Security Capital Group
Apr-18	Crows Nest/ St Leonards	201 Pacific Hwy	16,577	86,000,000	10,376	6.5%*	Centuria/Lederer	Abacus Property Group, Goldman Sachs

Source: RCA Analytics/CI *Approx.

DEVELOPMENT PIPELINE

Suburb	Completion Year	Project Address	Development Stage	Owner	NLA (sqm)
Crows Nest/St Leonards	Q4 2019	St Leonards Square - 472-494 Pacific Highway	Construction	Mirvac Group	4,200
Crows Nest/St Leonards	2020+	Electroboard - 18-20 Atchison Street	DA Applied	Electroboard	23,000
Macquarie Park	Q4 2019	45 Waterloo Road - Building C	DA Approved	John Holland Group	35,000
Macquarie Park	Mooted	11 Talavera Road	DA Approved	DEXUS Property Group	24,000
Macquarie Park	Mooted	8-12 University Avenue	DA Applied	Macquarie University	50,000
Macquarie Park	Mooted	95 Waterloo Road	DA Applied	Goodman	14,874
Macquarie Park	Mooted	396 Lane Cove Road	DA Applied	Frasers Property / Winten Property Group	45,000
Macquarie Park	Mooted	31-35 Epping Road	DA Applied	Harvey Norman Group	14,477
Macquarie Park	Mooted	Epicentre (Riverside Corporate Park) - Lot 8 Julius Avenue (Incl Lot 9)	DA Approved	ISPT Pty Ltd	34,194
North Sydney	Q1 2019	100 Mount Street	Construction	DEXUS Property Group	42,000
North Sydney	2020+	Shopping World Site - 1 Denison St	Site Works	Winten Property Group	63,000
North Sydney	2020+	118 Mount Street	Site Works	Zurich Australia Ltd	21,000

Source: PCA/CI

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OUR TEAM

BEVAN KENNY
MANAGING DIRECTOR, NORTH SYDNEY
+61 411 223 213

CHRIS VEITCH
DIRECTOR, INVESTMENT SALES
+61 434 566 355

NICK LOWRY
ASSOC. DIRECTOR, INVESTMENT SALES
+61 408 891 376

ANTHONY MERRETT
ASSOC. DIRECTOR, LEASING
+61 405 719 566

RIKKI WU
HEAD OF ASIA DESK
+61 2 8238 0022

CAROLINE TERIANTO
EXECUTIVE, RESEARCH & MARKETING
+61 2 8238 0051

CI AUSTRALIA PTY LIMITED
Level 7, 2 Elizabeth Plaza
North Sydney, 2060
www.ciaustralia.com.au