



HIGHLIGHTS

- The absence of any new developments completing in 2012 is expected to be the dominant driver of vacancy trends and will underpin a gradual decline from the current vacancy rate of 9.6%. Tenant moves in 2012 have largely represented a reshuffling of tenants without a material impact on occupancy levels. Tenant enquiry for 2013 and 2014 requirements is more expansionary in nature and despite some downsizing amongst selected financial and accounting firms indicates a likely pick up in net absorption beyond 2012.
- Rents are expected to follow this pattern with face rental growth over 2012 forecast to be in line with CPI, before increasing from mid/late 2013 and into 2014 as demand conditions improve in conjunction with further tightening in the vacancy rate. Incentives are also expected to start reducing from 2013.
- Prime core market yields average between 6.25% and 7.25% with the recent benchmark transfer of 126 Phillip Street providing further evidence, in addition to the prime sales recorded in 2011 that yields have tightened 25 to 50bps since late 2009. The yield spread between prime and secondary assets continues to remain stable, albeit at an elevated level compared to the historical average. With the cost and availability of debt favouring prime assets and tenant movements still showing a flight to quality, this yield spread will likely remain in place for the balance of 2012, although continue to offer value opportunities for investors in the secondary space.

SYDNEY CBD OVERVIEW

Table 1
Sydney CBD Office Market Indicators as at April 2012

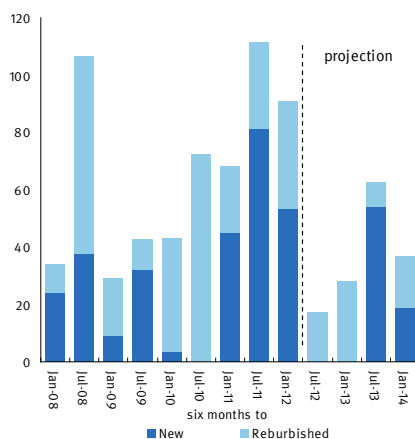
Grade	Total Stock (m ²) [^]	Vacancy Rate (%) [^]	Annual Net Absorption (m ²) [^]	Annual Net Additions (m ²) [^]	Average Gross Face Rent (\$/m ²)	Average Incentive (%)	Average Core Market Yield (%)
Prime	2,507,895	8.5	107,871	76,493	670 - 980 (870 Avg)	25.5	6.25 - 7.25 (6.83 Avg)
Secondary	2,421,472	10.7	-93,909	4,923	490 - 620 (554 Avg)	28.5	7.75 - 8.75 (8.18 Avg)
Total	4,929,367	9.6	13,961	81,416			

Source: Knight Frank/PCA NB. Average data is on a weighted basis [^] at January 2012

SUPPLY & DEVELOPMENT ACTIVITY

2011 gross supply additions of 192,968m² were recorded in the Sydney CBD office market. This was predominantly led by three major projects consisting of 1 Bligh Street (DEXUS/Cbus, 43,184m²), Darling Quarter (APPF/ADIA, 56,000m²) and 85 Castlereagh Street (Westfield, 32,837m²). While the 2011 gross supply figure was 15% above the 20 year average, supply over the next two years will be much softer. Annual gross supply across 2012 and 2013 is estimated to average 72,636m² per annum, equal to only 44% of the long term average. This is likely to see net supply turn negative given the advent of some stock withdrawals for development.

Figure 1
Sydney CBD Forecast Supply
Major New & Refurbished Gross Supply (000's m²)



Source: PCA/Knight Frank

In 2012, supply will be driven by refurbishment activity led by the 21,865m²

Table 2
Major Selected Tenancy Movements and Resulting Backfill Availability

Tenant	From	To	Approx Backfill Available	Date
CBA	52 Martin Pl	Darling Quarter	16,911m ²	Q2 2011
JP Morgan	Grosvenor Pl	85 Castlereagh St	7,700m ²	Q4 2011
JP Morgan	259 George St	85 Castlereagh St	8,060m ²	Q4 2011
Freehills	MLC	161 Castlereagh St	20,200m ²	Q1 2013
Corrs*	GPT, 1 Farrer Pl	8 Chifley	6,400m ²	Q3 2013
Macquarie Group	1 Martin Pl	48 Martin Pl [^]	36,000m ²	Q4 2014

Source: Knight Frank Estimates *Corrs Chambers Westgarth [^]includes adjacent building 9-11 Elizabeth St

second stage of ADIA and APPF's 1 O'Connell Street project. No major new developments are due to complete until 161 Castlereagh Street (GPT (GWOF)/La Salle/ISPT, 54,450m²) and 8 Chifley (Mirvac/K-REIT Asia 19,100m²) in 2013. Supply is likely to pick up from late 2014 with a number of DA approved projects looking to commence (refer Supply Map, page 3). Late 2014 examples could include 33,700m² at 5 Martin Place (Colonial/Cbus) and 13,500m² at 383 George St (Fife Capital). 2015 supply is expected to include the major projects of Barangaroo C4 (Lend Lease/SHFA, 82,000m²) and potentially 190-200 George Street by Mirvac (38,000m²), although 2016 looks more likely for this project.

Backfill Space

A large proportion of backfill space, both existing and forthcoming, stems from tenant relocations away from Martin Place (refer Table 2). Although CBA have vacated 5 Martin Place and ANZ will vacate 20 Martin Place, these assets will be redeveloped. Other buildings CBA have departed have been

absorbed such as 48 Martin Place (acquired by Macquarie Group for owner occupation) and 363 George Street, which is under Heads of Agreement. Should Westpac commit to Barangaroo, it is likely that premises such as 60 Martin Place, 33 Pitt Street, 182 George Street, 55 Market Street and 255 Elizabeth Street would be vacated. Although Martin Place will be a short term source of vacancies, over the medium term it is providing the opportunity for an extensive refurbishment of the precinct. Given the development plans already in place, the outcome is likely to see the reinvigoration of one of the CBD's best located precincts over the next few years.

Major backfill space currently available stems from JP Morgan's move into 85 Castlereagh St, while the move by Corrs Chambers Westgarth into 8 Chifley sees some forthcoming backfill at GPT, 1 Farrer Pl. Other smaller forthcoming options will result from moves to 1 O'Connell and 1 Bligh from tenants such as Middletons Lawyers (from 52 Martin Pl and 126 Phillip St), Crowe Horwarth (from 309 Kent St) and Oil Search (from 123 Pitt St).



MAJOR OFFICE SUPPLY

- 1 1 Bligh St - 43,184m² [Clayton Utz]
DEXUS/Cbus - July 2011 - 85% committed
 - 2 10-20 Bond St[#] - 38,340m² [Origin Energy & others]
Investa (IOF)/Mirvac - Q3 2011 - 90% committed[^]
 - 3 85 Castlereagh St - 32,837m² [JP Morgan/Westfield]
Westfield - Q4 2011 - 88% committed.
 - 4 1 O'Connell St[#] - 28,849m² [Crowe Horwath] - 32% committed[^]
APPF (Lend Lease)/ADIA - L8-16 Q3 2011, High rise 2012
 - 5 161 Castlereagh St (242 Pitt St) - 54,450 m² [ANZ/Freehills]
GPT (GWOF)/La Salle/ISPT - Q1 2013 - 90% committed.
 - 6 99 Elizabeth Street[#] - 8,437m²
Kyko Group - Q2 2013
 - 7 8 Chifley Square - 19,100m² [Corrs]
Mirvac/K-REIT Asia - Q3 2013 - 42% committed.
 - 8 5 Martin Place (120 Pitt St) - 33,700m²
Colonial (CPA)/Cbus - 2014+
 - 9 48 Martin Place[#] - ~18,000m²
Macquarie Group - 2014+
 - 10 52 Martin Place[#] - ~17,000m²
QIC - 2014+
 - 11 383 George St (38 York St) - 13,500m²
Fife Capital - 2014+
 - 12 Barangaroo C4 - 82,000m²
Lend Lease/SHFA - 2015+
 - 13 180 Thomas St - ~15,000m²
Transgrid - 2015+ (Stage 1 DA Approved)
 - 14 190-200 George St - 39,000m²
Mirvac - 2016+ (Stage 1 DA Approved)
 - 15 19-31 Pitt St - ~7,000m²
Cambooya - 2016+ (Stage 1 DA Approved)
 - 16 ANZ Building - 20 Martin Pl[#] - ~14,000m²+
Pembroke Real Estate 2014+
 - 17 Red Cross Building, 159 Clarence St - ~11,000m²
St Hilliers 2014+
 - 18 1 Martin Place[#] - 40,200m²
Charter Hall Office/ Macquarie Martin Place Trust - 2015
 - 19 Central Park (CUB site) - up to ~70,000m²
Fraser's - 2015+
 - 20 430-450 Pitt St (Belmore Park) - 22,500m²
Energy Australia - 2015+
 - 21 Barangaroo South - 205,000m² (over 2 further buildings)
Lend Lease /SHFA - 2016+
 - 22 33 Bligh St - 26,000m²
Energy Aust./Investa - 2016+
 - 23 333 George St - ~12,000m²
Charter Hall Core Plus Office Fund - 2016+
 - 24 289-307 George St (City One) - 65,000m²
Thakral - 2017+
 - 25 182 George & 33 Pitt - ~45,000m²
Westpac - 2017+
 - 26 George, Dalley & Pitt Sts - 35,000m²+
GE Real Estate - 2017+
 - 27 Loftus & Young Sts - 35,000m²
AMP - 2018+
 - 28 60 Martin Place - ~28,000m² (full redevelopment likely)
Investa/Private Investor - 2018+
- Under Construction/Complete**
- DA Approved / Confirmed / Site Works**
- Mooted / Early Feasibility**

NB. Dates are Knight Frank Research estimates
Major tenant precommitment in [brackets] next to NLA
Major refurbishment
Office NLA quoted
[^] includes NLA under negotiation/HOA



Source of Map: Knight Frank

TENANT DEMAND & RENTS

Expectations for economic growth close to trend in 2011 did not fully materialise, which has been reflected in a slowdown in the rate of net absorption. 2011 saw annual net absorption of 13,961m², equivalent to 27% of the long term average. With the simultaneous addition of 83,431m² of net supply, the vacancy rate increased to 9.6% as at January 2012 (PCA) compared to 8.3% a year ago.

Although vacancy on both a square metre and percentage basis remains tightest for Premium grade, it was this part of the market that contributed to the vacancy rise over the second half of the 2011 year. This was a result of the residual component of 1 Bligh Street not leased to Clayton Utz being included as completed stock (20,321m²) and 8,769m² of refurbished space at Chifley Tower. However pending lease commencements such as Commonwealth Government's Ministerial and Parliamentary Services (4,891m² commencing July 2012) and Oil Search (3,274m² commencing October) will serve to reduce this amount. Bloomberg have also leased two floors at 1 Bligh, however the net effect on premium vacancies will be minimal given they will relocate from Gateway.

Table 3
Sydney CBD Total Vacancy Rates
January 2011 to January 2012

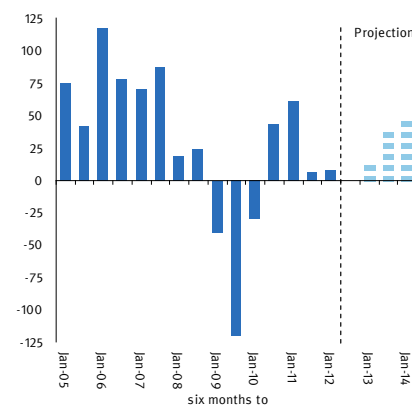
Grade	Jan 2011	July 2011	Jan 2012
	%	%	%
Premium	3.1	2.5	7.4
A Grade	9.4	9.9	8.9
B Grade	8.1	10.5	10.1
C & D Grade	9.2	10.0	11.8
Total	8.3	9.3	9.6

Source: PCA/Knight Frank

Net Absorption

Although Deloitte Access Economics forecast a 0.5% contraction in base office demand over 2012, this is driven by the finance and insurance sector where slowing credit growth is forcing banks to closely monitor costs. Excluding this sector, base office demand is forecast to post a modest rise of 0.7%. The impact on occupancy from a fall in finance and insurance employment is expected to be mitigated somewhat by major banks such as CBA and ANZ having already committed to leasing arrangements in new buildings. It is unlikely that any of this space would be sub-leased back to the market, although some legacy sub-lease space from ANZ at 347 Kent Street will become available. However as a result of this, the take up of new space as employment conditions improve from 2013 may be tempered somewhat. It is noted that the forecast for net absorption takes this into account and is reflected in no net absorption in the first half of 2012 before demand picks up gradually into 2013.

Figure 2
Sydney CBD Net Absorption
(000's m²) per six month period



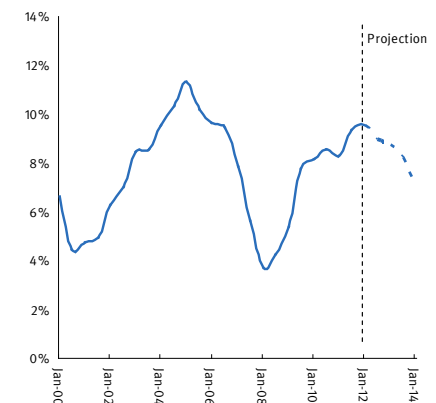
Source: PCA/Knight Frank

Anticipated Vacancy Levels

Despite tenant demand being more inconsistent than anticipated six months ago, this is expected to be outweighed by the supply side of the equation such that the current vacancy rate of 9.6% will represent the peak in the cycle. As economic growth returns to trend levels and demand subsequently improves, the rate of net

absorption will accelerate and the headline vacancy rate will contract to 7% by the end of 2013 and 5.7% by the end of 2014.

Figure 3
Sydney CBD Vacancy
% total vacancy



Source: PCA/Knight Frank

Tenant Demand

Reflective of the relatively flat net absorption anticipated for 2012, the majority of tenant enquiry for new space requirements in 2012 is largely for relocations to premises of commensurate size to existing rather than for expansion purposes. Underpinning these 2012 moves have been the favourable incentives on new leases compared to renewals. This relative value has been sufficient to justify the move by some tenants into higher quality facilities. As a positive, TAL (formerly TOWER Australia) is believed to have agreed to a forthcoming relocation from North Sydney to 363 George Street, which will add 9,872m² to net absorption.

However, in line with the improved outlook for occupancy beyond 2012, tenant enquiry for 2013 and 2014 space requirements reflect more of an expansion story. For instance Corrs in the second half of 2013 will increase occupied space by circa 3,000m² when moving into 8 Chifley, while enquiries from KPMG as well as the IT sector including Google will further add to net absorption. Firms such as Ashurst, Minter Ellison and DLA Piper amongst others see the legal sector currently seeking more than 40,000m² of space in the next three years, although the majority of this is commensurate with current



occupancy and is therefore not anticipated to have a material impact on net absorption.

Nevertheless, some pending downsizing in the market will temper the rate at which demand in the market recovers. In the accounting sector, PWC have indicated that they may reduce occupied space by circa 30% in 2014 when their lease expires at Darling Park Tower 2 in 2014, while should Ernst & Young commit to 190 George Street, where they are believed to be in exclusive negotiations with developer Mirvac, some further space will be given back to the market. In the financial sector, Macquarie Group's move to 48 Martin Place could see occupied space reduce by circa 10,000m².

Rental Levels

Rents maintained positive growth over the second half of 2011, albeit at a moderating pace given some inconsistent demand from tenants. Growth has predominantly been from face rents, which have tracked close to CPI with prime gross face rents now averaging \$870/m² (\$721/m² net), representing annual growth of 2.1%. Incentives have remained at

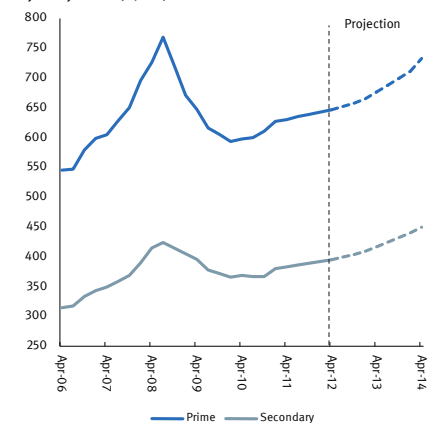
relatively high levels at approximately 26% on a gross basis. These estimates are based on average rates for a new lease and therefore the majority of portfolios will have weighted incentives of circa five percentage points lower given renewals incentives can be approximately three quarters of those for new leases.

In the secondary market average face rents on a gross basis now average \$554/m² (\$431/m² net). Despite the higher vacancies amongst secondary stock, annual rental growth was marginally higher for secondary. This was reflective of some repositioning of refurbished assets for some upper B-grade assets and is indicative of the opportunities available for owners prepared to spend some money on upgrading assets. Similar to prime, incentives have shown limited change, although new deals in the Core, Western and Midtown precincts are now sub 30%, albeit still in the high 20's.

Prime incentives in Sydney CBD are expected to hold relatively steady at approximately 25% during 2012. However as the vacancy rate tightens, prime incentives are forecast to

start reducing during 2013 and 2014 to 22.5% and 17.5% respectively. Traditionally face rent growth tends to start accelerating when incentives are below 20%, which indicates rental growth will be at its strongest in 2014. After projected prime rental growth broadly in line with CPI during 2012, effective rental growth of 6.9% is forecast in 2013 before accelerating to double digit growth in 2014.

Figure 4
Average Gross Effective Rents
Sydney CBD (\$/m²)



Source: Knight Frank

Table 4

Major Leasing Activity (New Leases over 1,000m² & Significant Renewals over 1,250m²) Sydney CBD

Address	Precinct	Area (sqm)	Term (yrs)	Lease Type	Tenant	Start Date
8 Chifley Square	City Core	8,080	12	Pre-commit	Corrs Chambers Westgarth	Oct-13
1 O'Connell Street	City Core	5,400	7	New	Middletons	Dec-12
GPT, 1 Farrer Place	City Core	6,149	10	Renewal	Goldman Sachs	Oct-12
1 Bligh Street	City Core	3,274	12	New	Oil Search	Oct-12
400 George Street	Midtown	1,803	10	New	Mills Oakley Lawyers	Aug-12
1 Bligh Street	City Core	4,891	12.7	Pre-commit	C'wealth of Aust.	Jul-12
1 O'Connell Street	City Core	3,100	10	New	Crowe Horwath	Jul-12
20 Bond Street	City Core	2,903	7	New	Hudson Recruitment	Jul-12
1 York Street	Western	1,720	8	Renewal	Clarius Group	May-12
1 O'Connell Street	City Core	2,416	8	New	Thomson Playford	Apr-12
Chifley Tower	City Core	5,878	10	New	Investec	Jan-12
Aurora Place, 88 Phillip Street	City Core	2,853	10	New	Bell Potter Securities	Jan-12
Angel Place, 123 Pitt Street	City Core	1,654	6	Renewal	Schroders	Jan-12
Grosvenor, 225 George Street	City Core	27,459	12	Renewal#	Deloitte Services P/L	Dec-11
464 Kent Street	Western	4,612	10	New	Red Cross	Dec-11
20 Bond Street	City Core	2,071	7	New	Institute Comp. Directors	Dec-11
44 Market Street	Western	4,988	5	New	ABS	Nov-11
Darling Park Tower 3	Western	1,465	5	New*	SFDC Australia Pty Ltd	Nov-11
60 Margaret Street	City Core	5,288	6	Renewal	Vero Insurance	Oct-11
Chifley Tower	City Core	2,559	6.17	Renewal	Morgan Stanley	Oct-11
363 George Street	City Core	2,448	6	New	Chandler Macloud	Oct-11

Source: Knight Frank

includes 5,000m² of expansion space

* expansion space for sitting tenant

INVESTMENT ACTIVITY & YIELDS

In total value terms, annual sales transaction activity has now increased to levels in excess of those achieved pre-GFC in 2007. This has been underpinned by strong offshore interest that has been focussed almost exclusively within CBD markets. In the 12 months to April 2012, total Sydney CBD sales above \$10 million amounted to \$2.47 billion. 43% of these sales have been acquired by offshore parties, who have generally sought large prime assets such as 259 George Street (albeit private), 20 Bridge Street and 8 Chifley. As a result the average purchase price for assets sold to offshore investors has been relatively high at \$133.5 million. So far in 2012, 333 Kent Street has been the only asset acquired by an offshore party with the Chinese-backed development group, Maville Australia Group purchasing the building for \$47.75 million on a core market yield of 8.4%.

A-REITs have been the largest net seller over the past year with a net purchase/sell of minus \$613 million in the 12 months to the end of April. These sales have been achieved at rates equivalent to, if not slightly above, book values. This has assisted in bridging the

gap between share prices and NTA's with proceeds being used to fund capital management initiatives such as share buy backs. Examples include Stockland selling their half stakes in both 7 Macquarie Place and 52 Martin Place to joint owners UniSuper and QIC respectively. The former asset sold for \$55 million (50%) in April 2012 and the latter for \$172.2million (50%) in November last year. The high cost of equity given the discount to NTA's is expected to remain a restraint on A-REIT purchasing activity in the near future.

The largest transaction so far in 2012 has been 126 Phillip Street, where Investa sold a 25% share to each of Investa Commercial Property Fund (ICPF) and IOF after each party exercised pre-emptive rights. Although a related party transaction to some extent, the transaction reflected a core market yield of 6.35% and equated to a rate of \$16,684/m². While the 8 Chifley sale in 2011 was considered to imply a degree of yield tightening for select prime assets when compared to some other recent sales, the 126 Phillip Street provides further evidence of at

least a 25bp tightening prime CBD yields since the peak in the yield cycle in late 2009. This tightening was further evidenced by ISPT's October 2011 purchase of a 25% share in 161 Castlereagh Street on a 6.5% yield, which shows a similar level of tightening compared to the 6.74% yield which GPT acquired a 50% share in the asset back in April 2010. As a result, average core market yields are estimated to range on average from 6.25% to 7.25% for prime assets.

Following the banks choosing to delay the disposal of non-performing assets until market conditions improved, some distressed sales are gently being fed to the market. At the end of 2011, the \$185 million sale of 20 Bridge Street was finalised with the asset purchased by RREEF Real Estate on behalf of an Asian institutional investor. The asset was sold by Korda Mentha, who had been appointed as receiver by BOSI following Record Realty having been placed into receivership three years ago. In February, Bond Store 3, located at 30 Windmill Street in Walsh Bay also transacted. The asset was sold by PPB Advisory as Receivers to the

Table 5

Recent Sales Activity Sydney CBD

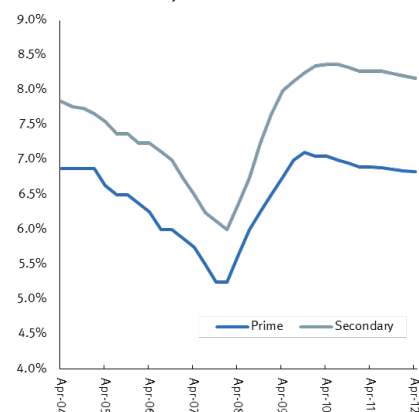
Address	Price (\$ mil)	Core Mrkt Yield (%)	NLA (m ²)	\$/m ² NLA	WALE (yrs)	Vendor	Purchaser	Sale Date
7 Macquarie Place	55.00 [^]	circa 7.0 to 7.25	13,582	8,099	2.7	Stockland	UniSuper	Apr-12
126 Phillip Street	176.25*	6.35	42,256	16,684	4.7	Investa Property Group	ICPF [#] /Investa Office Fund [†]	Mar-12
333 Kent Street	47.75	8.4	8,938	5,342	5.2	AMB Property	Maville Group Aust.	Feb-12
Bond Store 3	17.00	9.0	3,653	4,655	1.7	PPB Advisory	Primewest	Feb-12
20 Bridge Street	185.00	7.0	19,799	9,344	4.8	Korda Mentha as Receiver (BOSI)	RREEF	Dec-11
50 & 54 Park Street	90.00	n/a	18,138	4,962	Circa 5	AMP	Kyko Group	Nov-11
140 Sussex Street	84.00	7.8	12,440	6,752	5.6	Eureka Funds Management	RREEF	Nov-11
161 Castlereagh St	197.50*	6.5	58,300	13,550	11.2	Grocon	ISPT	Oct-11
52 Martin Place	172.20 [^]	7.0	39,140	8,799	28.7	Stockland	QIC Global Real Estate	Oct-11
8 Spring Street	37.50	7.8~	5,064	7,406	3.7	FKP Funds Management Ltd	Heathley Diversified Property Fund	Oct-11
1 York Street	117.70	7.9	18,401	6,397	1.5	Colonial (DPIF)	HNA Group	Sep-11
8 Chifley Square	154.37 to 169.80 ^{^†}	6.47	19,106	16,159	8.0	Mirvac	K-REIT Asia	Jul-11

Source: Knight Frank [^] 50% share * 25% share # exercised pre-emptive right to acquire 25% increasing ownership to 50%
[†] Pre-emptive right to acquire 25% share ~ Represents \$2.1m income support provided by the vendor
[‡] on completion transaction - final sale price depends on committed rental rates when the property is completed



wholesale private syndicator Primewest for \$17 million. Indicative of the buyer depth for CBD assets, the 'distressed' sales have not represented material discounts to market value. 20 Bridge Street transacted on a core market yield of 7.0%, while Bond Store 3 transacted on a core yield of 9.0%, which reflected some required capital expenditure, the relatively short 1.7 year WALE and leasehold interest.

Figure 5
Sydney CBD Average Yields
Prime and Secondary Core Market Yields



Source: Knight Frank

Secondary assets continue to offer significant opportunities to investors from an income perspective given the above average yield spreads to prime assets. Average core market yields are estimated to range on average from 7.75% to 8.75% for secondary assets, representing a spread of 135 bps to prime yields compared to the long term average of 106 bps. Sales that have taken advantage of this relative value include RREEF Real Estate acquiring 140 Sussex Street from Eureka Funds Management for \$84 million in November 2011. The upper B-grade asset was refurbished four years ago and was sold fully tenanted with a 5.6 year WALE. Another example was 8 Spring Street, which was acquired in October by Heathley Diversified Property Fund from FKP Funds Management for \$37.5 million. The asset had a 4.1% vacancy and a 3.7 year WALE. Both sales reflected core market yields of 7.8%, although for 8 Spring Street this was underpinned by \$2.1 million income support provided by FKP.

OUTLOOK

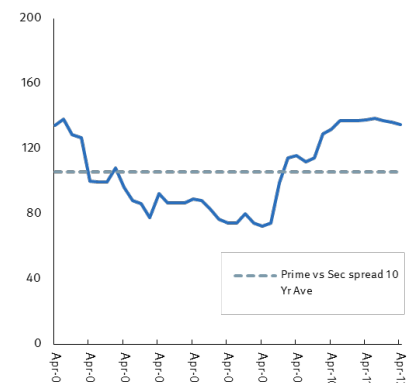
The outlook for the Sydney CBD office market will be shaped by an extremely soft supply pipeline over the coming two years. Notwithstanding current tenant demand being somewhat patchy, the absence of any new developments completing in 2012 is expected to be the dominant driver of vacancy trends and will underpin a gradual decline from the 9.6% vacancy recorded by the PCA in January. Completions in 2012 are low enough that 2012 withdrawals need only measure 50% of long run average levels for annual net supply to turn negative, an outcome that Knight Frank forecasts to eventuate. This underpins the forecast vacancy rate declining to 8.8% by the end of 2012 before reducing further in 2013 to 7.0% as demand conditions improve in conjunction with a lack of new supply. It is noted that this pick up in demand will be relatively gradual given some new enquiries being offset by several pending downsizes currently in the market.

Rental forecasts reflect this pattern. Over 2012, face rental growth is expected to track CPI, or 2.5%, with incentives showing no downward movement. However expectations of improved tenant demand in 2013 will see expanding tenants faced with fewer options given the next wave of development is unlikely to start completing in a meaningful way until at least late 2014. This is forecast to see prime face rental growth in 2013 and 2014 increase to an average of 4.5% per annum. Prime incentives are forecast to start materially reducing from mid/late 2013 to reach 17.5% on a gross basis by the end of 2014. This will underpin prime effective rental growth averaging almost 10% per annum during 2013 and 2014. Secondary assets are expected to show a similar pattern with rental growth accelerating from 2013, albeit at a slightly softer rate compared to that of prime assets. On a cautionary note, further deterioration of the sovereign debt problems in Europe could delay the timing of the rental upswing with some potential increases in financial sector sub-lease space.

With investor confidence having sufficiently improved to see transaction volumes levels above those recorded pre-GFC, demand for assets is expected to remain robust over 2012. Offshore interest, which has been the largest source of demand, will remain supported by Sydney CBD yields being well above other major global cities. Despite the AUD's strength against the USD, the currency is not necessarily acting as a deterrent given the comparatively strong performance of other currencies such as the Swiss Franc, Canadian Dollar and selected Asian currencies, where the majority of capital inflow is originating. Additionally, a number of domestic wholesale funds and larger syndicates remain in the market for CBD assets and will add further depth to the market. Conversely, listed A-REITs are likely to remain net sellers, however this should help facilitate some of the buyer enquiry currently in the market.

The positive expectations for rental growth over the medium term is forecast to maintain the tightening bias for core yields. Although the tightening cycle has thus far favoured well tenanted, prime assets, the above average spread between prime and secondary yields continues to present value opportunities for secondary assets. Nevertheless, with the cost and availability of debt favouring prime assets and tenant movements still showing a flight to quality, this yield spread will likely remain in place for the balance of 2012.

Figure 6
Risk premium – Prime vs Secondary
Sydney CBD (bps)



Source: Knight Frank



Americas

USA
Bermuda
Brazil
Canada
Caribbean
Chile

Australasia

Australia
New Zealand

Europe

UK
Belgium
Czech Republic
France
Germany
Hungary
Ireland
Italy
Monaco
Poland
Portugal
Romania
Russia
Spain
The Netherlands
Ukraine

Africa

Botswana
Kenya
Malawi
Nigeria
South Africa
Tanzania
Uganda
Zambia
Zimbabwe

Asia

Cambodia
China
Hong Kong
India
Indonesia
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The Gulf

Bahrain
Abu Dhabi, UAE

Knight Frank Research

Matt Whitby

National Director
Head of Research and Consultancy
+61 2 9036 6616
Matt.whitby@au.knightfrank.com

Nick Hoskins

NSW Research Manager
+61 2 9036 6766
Nick.hoskins@au.knightfrank.com

Commercial Agency Contacts - Sales

Stephen Ellis

Executive Chairman
+61 2 9036 6611
Stephen.ellis@au.knightfrank.com

James Parry

National Director
& Head of Capital Transactions - NSW
+61 2 9036 6758
James.parry@au.knightfrank.com

Richard Horne

National Director, Investment Sales
+61 2 9036 6622
Richard.horne@au.knightfrank.com

Richard Garland

Director, Commercial Sales & Investments
+61 2 9036 6744
Richard.garland@au.knightfrank.com

John Bowie Wilson

Director – City Sales
+61 2 9036 6743
John.bowiewilson@au.knightfrank.com

Commercial Agency Contacts - Leasing

Andy Collins

National Director, Office Leasing
+61 2 9036 6641
Andy.collins@au.knightfrank.com

Jonathan Lavery

Director, Office Leasing
+61 2 9036 6799
Jonathan.lavery@au.knightfrank.com

Murray Lee

Director, CBD Office Leasing
+61 2 9036 6745
Murray.lee@au.knightfrank.com

Knight Frank Valuations

David Castles

State Director, Knight Frank Valuations
+61 2 9036 6648
David.castles@au.knightfrank.com

Peter Inglis

Associate Director, Knight Frank Valuations
+61 2 9036 6773
Peter.inglis@au.knightfrank.com

Adam Elias

Associate Director, Knight Frank Valuations
+61 2 9036 6771
Adam.elias@au.knightfrank.com

Tim Miles

Associate Director, Knight Frank Valuations
+61 2 9036 6701
Tim.miles@au.knightfrank.com

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