RESEARCH

MAY 2010

PERTH CBD OFFICE

Market Overview

Knight Frank

HIGHLIGHTS

- Just over 68,000 sq m of office space was completed during 2009. The level of new supply to be added between 2010 – 2012 is predicted at 228,269 sq m, of which over 70% is pre-committed.
- The total vacancy as at January 2010 was 8.2%, up 0.2% from July 2009. New stock and backfill opportunities being released into the market over the next twelve months is anticipated to increase the vacancy rate to 9.7% by the close of 2010. The completion of C2 City Square at the start of 2012 will see vacancy levels peak at 10.1%, though with increased demand, positive net absorption and no new development supply beyond this time we should see the vacancy rate decrease to historical levels thereafter.
- Prime and secondary grade rents stabilised over the first quarter of 2010. There is now downward pressure on incentives, particularly in quality grade buildings.
- Yields have returned to historic levels of 7.5% to 8.5% for prime-grade office property and 8.5% to 9.5% for secondary-grade properties.

Table 1
Perth CBD Office Market Indicators as at April 2010

Grade	Total Stock (m²)^	Vacancy Rate (%)^	Annual Net Absorption (m²)^	Annual Net Additions (m²)^	Average Net Face Rent ($/m²)	Average Incentive (%)	Average Core Market Yield (%)
Prime	708,360	7.95	-144,692	81,325	643	17.5	8.14
Secondary	661,902	8.52	127,231	-2,614	459	20.0	8.86
Total	**1,370,262**	**8.20**	**-17,461**	**78,711**			

Source: Knight Frank/PCA ^as at January 2010
Core Market Yield: The percentage return/yield analysed when the assessed fully leased market income is divided by the adopted value/price which has been adjusted to account for property specific issues (ie rental reversions, rental downtime for imminent expiries, capital expenditure, current vacancies, incentives, etc)

PERTH CBD OFFICE OVERVIEW

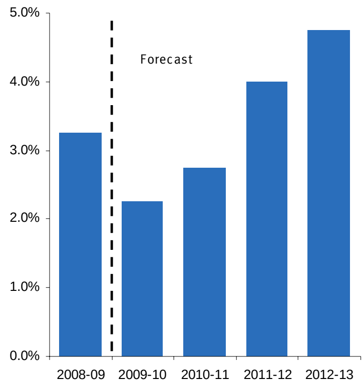
Despite the sharp economic downturn in 2008/09, the Australian economy remained resilient and exceeded expectations. This can largely be attributed to strong growth in China, which continues to demand high volumes of Australian exports.

Australia's economic performance can also be attributed to the Federal Government's monetary and fiscal stimulus which has encouraged spending throughout Australia and protected jobs. This has prevented the Australian economy reaching the lows experienced by the majority of advanced economies. The Australian economy is now in recovery mode with the GDP growing by 2.7% for the year ending December 2009.

The Western Australian economy has been cushioned from most of the economic downturn by the continued demand for resources produced by the State. As a result the Gross State Product is forecast to grow in Western Australia beyond 2010. This is expected to be assisted by a strong rebound in business investment from 2011, with the Gorgon Liquefied Natural Gas project reaching peak construction in 2012/13 and the global economic recovery gathering strength from 2010 onwards.

The resources boom in Western Australia has seen corresponding above average population growth, from both interstate and overseas migration. The City of Perth recorded the fastest increase in population numbers in Australia between 2008 and 2009, with an increase of 12.8% over the twelve-month period.

Figure 1
Forecast Economic Growth
% p.a. Real Gross State Product Growth



Source: WA Department of Treasury and Finance

Continued strong population growth will bring about demand for infrastructure by the local community, and with State Government and private sector investment in development and construction projects this would further add to growth in the Western Australian economy. It is anticipated State Government spending will tighten as concern shifts from the economic crisis to budget deficits. However, current State projects under construction such as the Fiona Stanley Hospital and the Ord East Kimberley expansion will assist with economic growth in Western Australia.

WESTERN AUSTRALIA WILL BE ASSISTED BY A STRONG REBOUND IN BUSINESS INVESTMENT FROM 2011

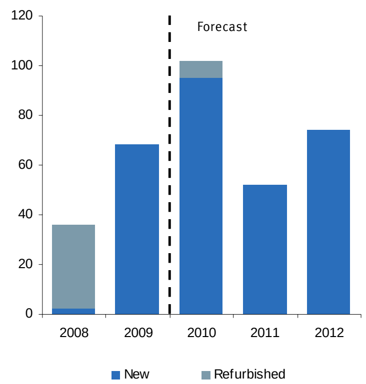
Private sector construction in the Perth CBD was underpinned by strong rental growth in 2006 to 2008 and demand for office space, with high levels of pre-commitment to new developments. Perth will continue to see capital invested in the property market as the economy remains in growth mode, particularly in comparison to the global environment, further driving demand and subsequent supply.

SUPPLY & DEVELOPMENT ACTIVITY

Development Cycle

The demand for new space, as a result of the resources boom in 2006/07, saw many new projects in the Perth CBD office market being initiated and developed – five of which were completed during 2009. Providing just over 68,000m² of office stock to the area, most of this prime-grade space has been fully leased to tenants such as NAB, Macquarie and Shell.

Figure 2
Perth CBD Supply
'000m² new and refurbished stock



Source: Knight Frank/PCA

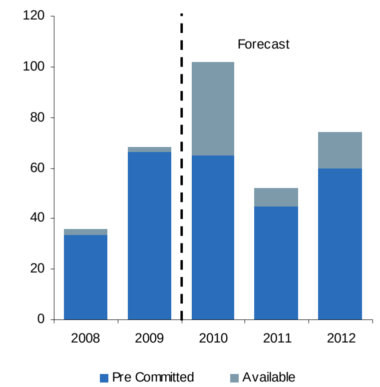
Six developments currently under construction and due for completion this year, including Alluvion and 140 William Street, will bring the total prime-grade office development in 2010 to 102,054m². With the recent delay in construction, Raine Square is now scheduled for completion during the first quarter of 2011. Together with 181 Adelaide Terrace the supply of new stock to the market will continue in 2011, providing 52,215m² of prime-grade space. C2 City Square, BHP's new head office in Western Australia, is due for completion in 2012 with a total of 74,000m² of office space.

The impact of weak economic and tightening credit conditions in 2008/09 has affected the pipeline of proposed developments beyond 2012. Many projects that were proposed for construction or refurbishment now require significant pre-commitment prior to works commencing and have been deferred. With deferred development proposals of up to 280,000m², this hold on new construction/refurbishment will dramatically curtail the amount of new space coming onto the market through to 2015.

Commitment Levels

The significant demand for office space in the Perth CBD during the recent resources boom resulted in a sharp reduction in vacancy levels as the available office stock was absorbed by growing companies requiring new space.

Figure 3
Perth CBD – Commitment Levels
'000m² commitment to supply



Source: Knight Frank/PCA

As a consequence of reduced levels of available office stock, several projects were able to secure strong levels of pre-commitment (an average of 74%) enabling construction to be undertaken on many new projects, with the next three years seeing the completion of these developments. With such high levels of commitment to these projects, any available space in the market is expected to come from backfill vacancies and potential sub-letting opportunities. One significant opportunity will be the backfill of the Bankwest tenancy at 108 St Georges Terrace in 2011. With the improvement in economic conditions, and no commitment to projects beyond 2012, the level of space available to tenants is expected to decrease and as such impact on vacancy levels and rental rates.

Development Sites

Vacant development sites within the Perth CBD area are limited. The majority of opportunities available are for redevelopment or refurbishment on existing developed sites. The trend for development within the Perth CBD is for office, retail and residential projects in the area between Barrack Street and the Freeway with the Eastern precinct tending to be redeveloped into residential apartment living, with a small office component at street and podium level.

The previous twelve-month period saw one sale of a development site in the Perth CBD. Finbar International Limited purchased the site at 143 Adelaide Terrace from Saville Australia for $10.6 million in June 2009. This 4,481m² site, now renamed Times 2 Apartments, is currently under construction with the development of two, ten-storey apartment buildings. Recent reports have noted the potential sale of 12 Mounts Bay Road, the site to the riverside of City Square; however details are currently unavailable to the public.

Broadly, Perth CBD land values are estimated at $2,000 to $3,000 per square metre (ex GST) in the Eastern locations, including Adelaide Terrace and the northern perimeter. Prime land rates for commercial/residential redevelopment are thought to be $3,000 to $5,000 per square metre (ex GST).

MAY 2010
PERTH CBD OFFICE
Market Overview

MAJOR OFFICE SUPPLY

01 226 Adelaide Terrace - 14,009 sqm
First State Group - Q2 2010

02 140 William Street - 35,000 sqm
Cbus Property - Q3 2010

03 161 St Georges Terrace - 10,500 sqm
Insurance Commission of WA - Q2 2010

04 Alluvion, 54-58 Mounts Bay Road - 22,140 sqm
Cape Bouvard / Commonwealth Property Office Fund - Q2 2010

05 Dynon Plaza, Milligan and Hay St - 13,360 sqm
Stamford Group - Q2 2010

06 125 St Georges Tce (C2 City Square) - 75,000sqm*
Brookfield Multiplex - Q2 2012

07 50 St Georges Terrace - 7,045 sqm (refurb)
St Martins - Q4 2010

08 Raine Square, 298-306 Murray Street - 45,100 sqm
West Gem Investments - Q1 2011

09 181 Adelaide Terrace - 7,115 sqm
Finbar - Q4 2011

10 Bishops See - 17,989 sqm
Hawaiian / Brook.Multiples - Completed 2009

11 432 Murray Street - 4,780 sqm
Gallway Investments - Completed 2009

12 503 Murray Street - 7,250 sqm
Fairworld Holdings - Completed 2009

13 100 St Georges Terrace - 31,019 sqm
ISPT No 2 - Completed 2009

14 2 Victoria Avenue - 7,200 sqm
Stockland - Completed 2009

15 187 Adelaide Terrace - Up to 20,000 sqm
DA Approved, pre-commitment required

16 396 Murray Street - 28,000sqm
DA Approved, pre-commitment required

17 123 St Georges Terrace (City Square) - 24,000 sqm
DA Approved, pre-commitment required

18 239 St Georges Tce (Bishops See #2) - 46,000 sqm
DA Approved, pre-commitment required

19 999 Hay Street - 9,800 sqm
DA Approved, pre-commitment required

20 257 Adelaide Terrace - 6,000 sqm
DA Approved, pre-commitment required

21 Capital Square (old Emu Brewery site) - 57,000sqm
DA Lodged

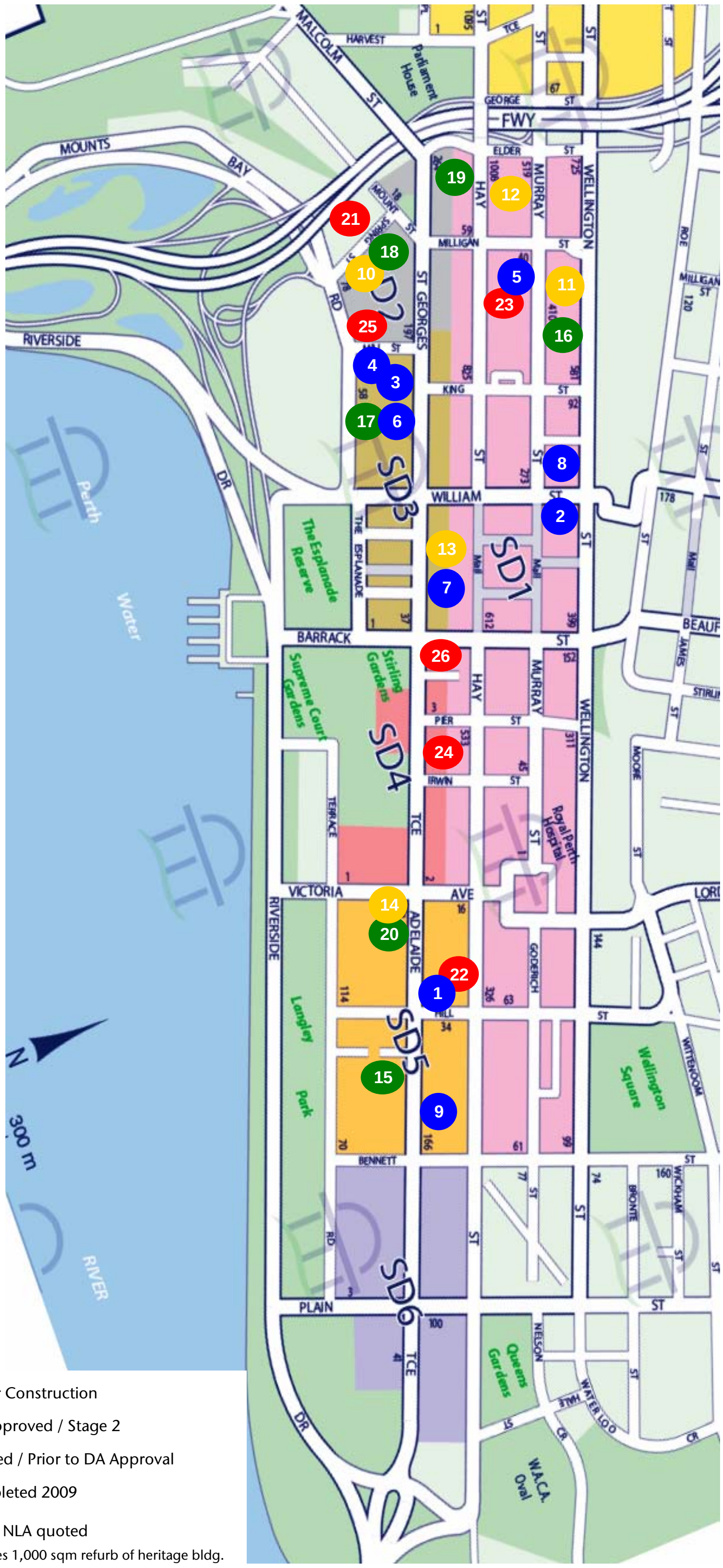
22 339 Hay Street - 12,200 sqm
Mooted

23 924 Hay Street - 12,000 sqm
Mooted

24 32 St Georges Terrace - 13,000 sqm (refurb)
Mooted

25 1 - 5 Mill Street - 34,000 sqm
Mooted

26 Treasury Building - Up to 20,000 sqm
Mooted



Under Construction
DA Approved / Stage 2
Mooted / Prior to DA Approval
Completed 2009

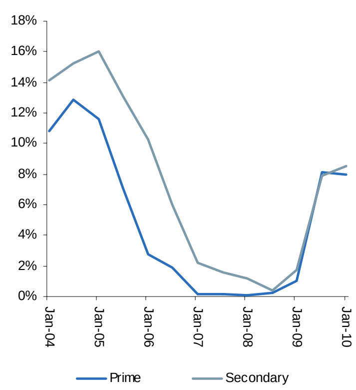
Office NLA quoted
* includes 1,000 sqm refurb of heritage bldg.

TENANT DEMAND & RENTS

As at January 2010, the Perth Central Business District consisted of 1,370,262m² of net lettable office space, of which 112,739 was vacant. Total vacancy was 8.2%, up marginally from 8.0% in July 2009, of which 5.5% (74,951m²) was direct vacancy. This is the highest level of total vacancy that the Perth CBD office market has seen since July 2005 and up from the lows experienced during the boom-time of 0.3% in July 2008.

In the six-month period to July 2009 there was a significant increase in the level of total vacancy in the office market, most particularly in direct vacancies when compared to rates at the start of 2009. The movement of tenants into newly completed space, and the subsequent relocation vacancy, as well as softer economic conditions can account for these increases.

Figure 4
Perth CBD Historical Vacancy
% vacancy



Source: PCA

In terms of quality grades, overall vacancies increased in the six months to January 2010. Premium grade vacancies increased from 2.2% to 5.7% (0.0% in January 2009) but decreased in A-Grade buildings over the same period from 10.8% to 8.9% (1.5% in January 2009). The secondary office vacancy has risen in line with prime-grade vacancies over the past twelve-months. B-Grade properties had a rise in vacancy level in the six-month period to January 2010 to 9.8% (from 7.5% in July 2009).

Table 2
Perth CBD Vacancy Rates
January 2010

Grade	Vacancy % Jan 2009	Vacancy % Jan 2010
Prime	1.03	7.95
Secondary	1.70	8.52
Total Market	**1.28**	**8.20**

Source: PCA

Net Absorption

Following a period of high vacancy levels and with the advent of strong economic conditions and no new office space supply in the Perth CBD, strong positive net absorption of 144,063m² was recorded between January 2004 and January 2006. Positive net absorption continued to be recorded to July 2008 as the Western Australian economy continued to grow, however as available space in all grades of buildings reduced significantly, this curbed take-up. The vacancy was down to 0.0% in premium-grade space in 2008. Actual levels of net absorption reduced as a result of no space being available in the market for lease.

With the onset of the global financial crisis at the end of 2008, two six-month periods of negative absorption were recorded in January 2009 and July 2009 as a result of reduced requirements in the market. Corresponding increases in total vacancy were also recorded in this period, but with renewed confidence in both the local and international economy positive net absorption of 4,451 m² was recorded in the six-month period to January 2010.

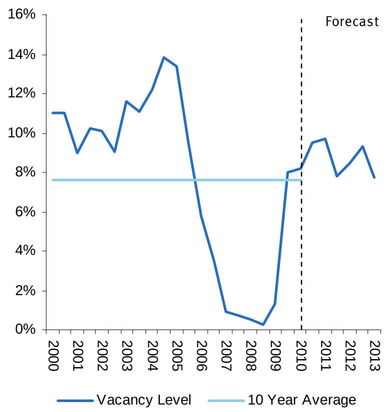
Existing tenants and the requirements of new tenants moving into the Perth Central Business District will see net demand for space increase. Although new development supply will be released into the market during 2010 positive net absorption should continue over the year as this space is leased.

Anticipated Vacancy Levels

Over the last 10 years, total vacancy levels in the Perth CBD office market have seen highs of 13.9% (July 2004) to lows of 0.3% (July 2008) . In January 2010 the Property Council of Australia reported the total vacancy rate at 8.2%, which is slightly above Knight Frank's calculated ten-year average of 7.6%.

In 2010 there is an anticipated supply of over 102,000m² of new or refurbished stock being released into the market, and our research estimates that 63% of this is pre-committed. The release of this additional new supply to the market should see the vacancy rate rise to 9.7% by the close of 2010.

Figure 5
Perth CBD Vacancy
(%) total vacancy



Source: Knight Frank/PCA

The end of 2011 should see the vacancy level decrease to 8.5% due to continued improvement in the economy and net positive movement of tenants into the CBD. Knight Frank anticipate an additional net take-up of stock per year of 50,000m² in 2011 and 2012, but with the completion of C2 City Square at the start of 2012 an increase in the peak vacancy level to 10.1% is anticipated, though this is expected to decrease to 7.7% by the close of the year. With no new development supply after this time, it is anticipated that vacancy levels will further decrease and stabilise at historic averages at 6.0% to 7.5% beyond 2012.

The vacancy rate beyond 2012 is dependent on the delivery of further supply, which is expected to be increasingly pre-commitment driven during that phase of the development cycle.

Table 3
Major Perth CBD Requirements
May 2010

Tenant	Requirement (sqm)	Timing
WA Police	4,000	2010
Commonwealth DPP	1,700	2010
ENI Australia	5,000	2011
Other Groups	8,000	2012

Source: Knight Frank

Tenant Demand

Tenant demand stabilised and improved from Q4 2009 and should continue to filter through to 2010 and 2011 as business confidence grows. Recent activity has seen enquiries for both small and large office areas in prime and secondary grade buildings. The greatest demand still remains for the prime area from Barrack Street west to the Freeway, which is reflected in the rental premiums commanded in this district.

Demand for space by government agencies may potentially decrease in the future as the State Government seeks to decentralise some departments, and therefore office space, to suburban centres such as Herdsman and Murdoch.

Rental Levels

Rental levels have fallen from the boom of recent times and incentives in leasing activity have re-emerged. The end of 2009 and the first quarter of 2010 have seen a stabilisation in face rental levels, particularly in the prime building market. Prime net face rents on average for the Perth CBD, to April 2010, were between $550 and $750 per square metre, with an average 17.5% incentive. Currently there is stabilisation in face rents and downward pressure on incentives; therefore we anticipate that the average 'effective' rental level will increase moving through 2010.

Pre-committed stock for buildings currently under construction had rental levels struck at a discount to market levels, appealing to tenants in a market where rental rates were high. With these developments close to being fully leased, there will remain a shortage of available quality stock in the market, which could in the future apply pressure on rents within prime-grade buildings.

CURRENTLY THERE IS STABILISATION IN FACE RENTS AND SOME DOWNWARD PRESSURE ON INCENTIVES

Secondary grade buildings remain vulnerable to long term vacancy and income erosion as the overall standard of accommodation across the Perth CBD increases as a result of the recent building cycle. The average net face rent for secondary-grade buildings, to April 2010, is $450 to $475 per square metre with incentive levels of approximately 20%.

Table 4
Recent Leasing Activity Perth CBD

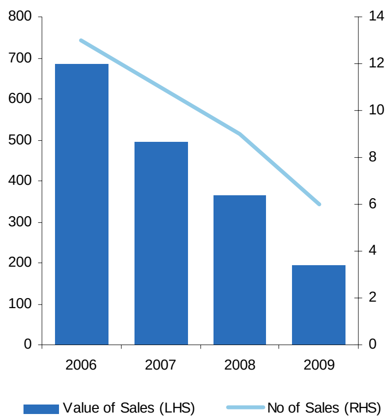
Address	Area (sq m)	Face Rental ($/m²)		Term (yrs)	Incentive (%)`	Lease Type	Start Date
Hyatt Commercial, Adelaide Terrace	558	425	n	5	-	Lease Renewal	June 2010
16 St Georges Terrace	773	420	n	2	-	New Lease	May 2010
140 St Georges Terrace	1,048	575	n	5	-	Lease Renewal	May 2010
Exchange Plaza	2,502	750	n	5	2.5	New Lease	May 2010
Australia Place	321	550	n	5	20	New Lease	April 2010
Exchange Plaza	606	740	n	5	15	Sub Lease	April 2010
100 St Georges Terrace	348	625	n	5	21	New Lease	February 2010
Australia Place	507	465	n	7	24	New Lease	February 2010
111 St Georges Terrace	976	640	n	5	-	Extension	February 2010
251 St Georges Terrace	2,033	450	n	7	11	New Lease	February 2010
16 St Georges Terrace	1,005	375	n	6	-	New Lease	January 2010
111 St Georges Terrace	522	522	n	2.6	-	New Lease	January 2010
216 St Georges Terrace	581	550	n	5	12	New Lease	January 2010

Source: Knight Frank n = net `Knight Frank's estimation of incentive calculated on a straight line basis.

INVESTMENT ACTIVITY & YIELDS

Tighter credit conditions, reduced loan to value ratios by banks and the risk associated with property investment all affected transaction activity across the Perth CBD in 2009 which was well down on previous years, both in terms of number and dollar value of sales.

Figure 6
Perth CBD Major Sales
($mil) Sales Volume ›$5mill & Number



Source: Knight Frank

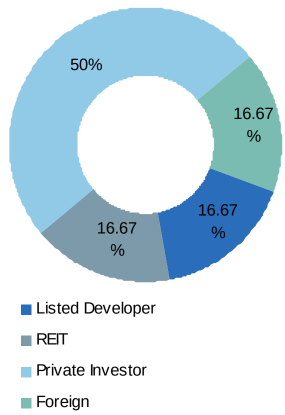
The investment market has seen six major transactions over the year to December 2009, which is down on previous years. The total value of sales during 2009 has been $193 million, half of which was supported by the November 2009 sale of a 50% share in Alluvion, 54-58 Mounts Bay Road. Alluvion was sold for $95 million by the Charter Hall Group and purchased by the Commonwealth Property Office Fund. This A-grade office development is currently under construction and is scheduled for completion in the middle of 2010 providing 22,140 square metres of office space. Alluvion is 100% pre-committed to tenants such as Cape Bouvard, Clough projects, North West Shelf and Shipping Service Company and Euroz Securities.

Private investors were the most active segment of the market in 2009 accounting for half of all transactions during the year for a total value of $52.45 million (27% of value).

Private investor interest continues to dominate the Perth CBD market into 2010 although we have witnessed the re-entry of interest by institutional owners and overseas (Asian and European) investors.

As the pressure to sell assets has alleviated over the past year, the pool of income-producing assets available for sale has reduced. The limited number of sales in the market proved problematic in assessing yields in the marketplace. However with the sale of Alluvion, at an initial yield of 7.74% inclusive of income 'top up', a benchmark has been provided for office investment property in the Perth CBD.

Figure 7
Perth CBD Purchaser Profile
Sales ›$5mill 2009



Source: Knight Frank

At the end of 2009, and into the first quarter of 2010, indicators show that prime yields had stabilised and returned to historic levels in the range of 7.5% to 8.5%, up from boom time averages of around 6.5% - 7.0%. Yields for secondary grade properties sit in the range of 8.5% - 9.5%, reflecting caution from

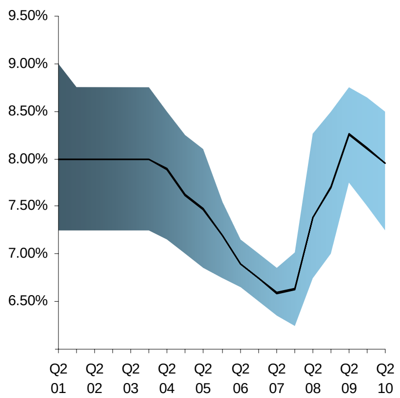
Table 5
Recent Sales Activity Perth CBD

Address	Price ($ mill)	Core Market Yield (%)	NLA (sq m)	$/m²	Vendor	Purchaser	Sale Date
54-58 Mounts Bay Road	95.00	7.90	22,417	8,476	Charter Hall Group	Commonwealth Property Office Fund	November 2009
23 Barrack Street	7.50	8.70	1,206	6,219	MPH Resources Pty Ltd	Hire Intelligence International Ltd	October 2009
249 Adelaide Terrace	6.95	Vacant Possession	1,297	5,359	Receiver for Saville Australia	Grand Lodge of WA of Ancient Free & accepted Masons Inc.	July 2009
143 Adelaide Terrace	10.60	Vacant Land	4,481 (Land)	2,365	Receiver for Saville Australia	Finbar International Ltd	June 2009
172 St Georges Terrace	34.98	9.96	6,264	5,585	GE Real Estate	Eastern Lighterage Co Pte Ltd	June 2009
81 St Georges Terrace	36.61	11.49	11,910	3,074	Macquarie Direct Property fund	Aviling Pty Ltd	March 2009

Source: Knight Frank
Core Market Yield: The percentage return/yield analysed when the assessed fully leased market income is divided by the adopted value/price which has been adjusted to account for property specific issues (ie rental reversions, rental downtime for imminent expiries, capital expenditure, current vacancies, incentives, etc)

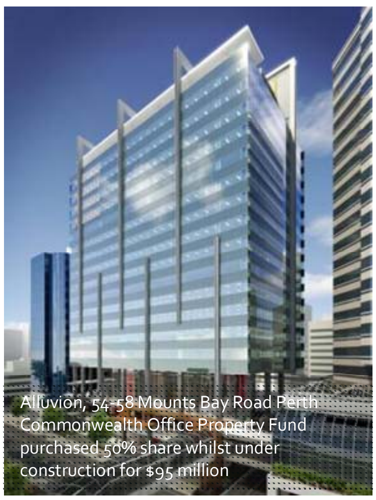
the market in regard to income generation from these properties when competing with newer supply. Most weight again is being placed on passing income, and hence passing yield – investors appear reluctant to pay for any future growth.

Figure 8
Perth CBD Yields
Prime Core Market Yield Range



Source: Knight Frank

MOST WEIGHT IS AGAIN BEING PLACED ON PASSING INCOME AND HENCE PASSING YIELD


Alluvion, 54-58 Mounts Bay Road Perth
Commonwealth Office Property Fund purchased 50% share whilst under construction for $95 million

OUTLOOK

The recent economic boom saw the demand for office property and space within the Perth Central Business District increase, leading to a reduction in supply, record low vacancy rates and exponential growth in rents. The demand for office space fuelled the development cycle with 104,177 square metres of stock constructed in 2008/09 and a further 228,269 square metres of space due for release by the end of 2012.

Since mid-2008, financial constraints in the market have significantly impacted upon potential office development, with many projects that were in the development pipeline now deferred pending significant pre-commitment levels or have simply been suspended. Without any major new developments in the short to medium term future, the supply of stock should tighten thus impacting on rents achieved.

The completion of new developments within the CBD and the subsequent relocation of tenants to those new buildings will see the vacancy rate increasing in the next twelve months to 9.7%, dropping over 2011 to 8.49% and peaking at 10.1% in the first quarter of 2012 as the supply of office stock in the market is added to and backfill opportunities come onto the market. The relocation of Bankwest to Raine Square will see a major backfill vacancy occurring at 108 St Georges Terrace, releasing over 20,000 square metres of stock in 2011.

During 2012 we anticipate that there will be strong take-up and positive net absorption of office stock in the market which should see the vacancy rate drop to 7.7% by the close of 2012. With no new stock under construction beyond 2012 we should see further reductions in the vacancy rate as stock is absorbed by the market.

Ongoing economic growth in Western Australia will be a prime driver for the continued stabilisation of rental rates in the office market, potentially leading to the underwriting of future office development in the Perth CBD.

ONGOING ECONOMIC GROWTH WILL BE A PRIME DRIVER FOR THE CONTINUED STABILISATION OF RENTAL RATES

Recent times have seen rental rates stabilise in the Perth CBD office market. However there is now downward pressure on incentives as the market strengthens with growing demand, despite new supply in 2010. Secondary buildings, and those with smaller floor plates, may however see erosion in rental rates realised as these properties will be competing with newer accommodation coming online.

It is anticipated that yields will remain at their current levels of 7.5% to 8.5% for prime grade and 8.5% to 9.5% for secondary grade in the immediate future, though interest rate rises may limit yield rate contractions. However, any future undersupply in prime grade space may drive rental growth and put downward pressure on yields.

PRIME YIELDS ARE LIKELY TO REMAIN AT CURRENT LEVELS IN THE IMMEDIATE FUTURE

RESEARCH

Americas
USA
Bermuda
Brazil
Caribbean
Chile

Australasia
Australia
New Zealand

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

Africa
Botswana
Kenya
Malawi
Nigeria
South Africa
Tanzania
Uganda
Zambia
Zimbabwe

Asia
Cambodia
China
Hong Kong
India
Indonesia
Macau
Malaysia
Singapore
Thailand
Vietnam

The Gulf
Bahrain

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