



PERTH
CBD

OFFICE MARKET OVERVIEW SEPTEMBER 2016

HIGHLIGHTS

Limited development in the pipeline for the Perth CBD will allow the current amount of vacant space to be absorbed over the next few years and in turn begin to lower the vacancy rate.

Throughout the remainder of 2016 and into 2017, it is expected that the vacancy rate will remain above 20% as demand remains moderately weak and supply gets absorbed.

A depreciating Australian dollar and lower interest rates are attracting international investor interest into the Perth market and counter-cyclical opportunities now exist.

KEY FINDINGS

The Perth CBD vacancy rate increased to 21.8% as at July 2016 from 16.6% a year ago, the highest level recorded in 21 years.

Office supply over the next 12-24 months will be benign as the CBD aims to absorb the newly developed stock currently vacant

The Perth CBD recorded negative net absorption in the six months to July 2016 - prime totalling positive 650m² and secondary totalling negative 17,891m².

Incentive levels are expected to remain high and currently average around 45-50% of net rent.

Asian interest in the investment market is beginning to grow, with three recent sales to Asian buyers.



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SUPPLY & DEVELOPMENT

The office market experienced increased supply in recent years however a hiatus in new supply will now occur over 2017 and 2018, allowing the current vacancy to be absorbed.

There was 30,582m² of new supply added to Perth CBD stock since January 2016. This comes after an oversupply seen in late 2015 of 113,463m² of newly developed or refurbished stock. New stock for 2016 includes the Kings Square 1 development of 22,612m² completed in January being the only newly developed building of 2016 with the remaining new supply being refurbished stock. These include 255 and 267 St Georges Terrace amounting to 589m² and 1,500m² respectively, enhancing the newly purchased Channel 9 headquarters and 55 St Georges Terrace adding 6,470m² of partially refurbished stock into the CBD.

With developments reaching completion, developers have altered their frame of mind and are adopting a more cautious approach with new developments only moving into construction once a strong level of pre-lease commitment has been secured. Looking forward for the next two years there is only one major new development that is 100% pre-committed. The Capital Square development, known as Woodside's new headquarters located at 98-124 Mounts Bay Road (previously the Emu Brewery Site). This 48,484m² development commenced construction in late 2015 and is due for completion in mid 2018.

There is little to no refurbishment works across the next two years but it is expected that some owners will assess their situation and work towards making their asset more presentable and leaseable, especially in the B Grade stock pool. Beyond these small refurbishments

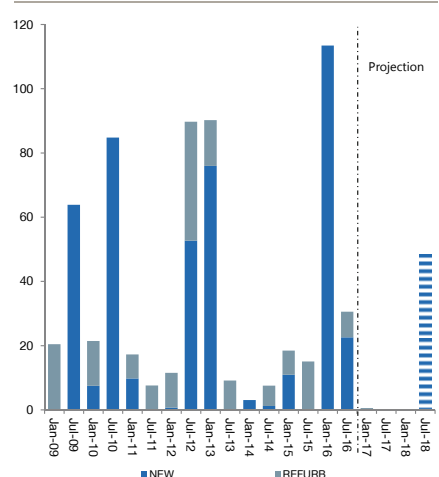
office development will be limited over the next two years which will help to cushion the market. The return of positive tenant demand aligned with little to no supply in the pipeline indicates a level of stability for the market in the near future.

Supply in the Perth CBD market is heavily skewed to A and B Grade stock with B Grade stock increasing each six monthly period accounting for 35% of the total stock currently vacant in the CBD. This trend will continue as tenants take this opportunity to move into better quality space. They will negotiate more economical terms as the market bottoms out with increasing vacancy, falling rents and attractive incentives to entice the move.

FIGURE 1

Perth CBD Office Supply

New and Refurbished Stock ('000m²)



Source: Knight Frank Research/ PCA

TABLE 1

Perth CBD Office Market Indicators as at July 2016

Grade	Total Stock (m ²)	Vacancy Rate (%)	Annual Net Absorption (m ²)	Annual Net Additions (m ²)	Average Net Face Rent (\$/m ²)	Average Incentive (%)	Average Core Market Yield (%)
Prime	1,082,486	18.8	57,157	132,622	528—625	45-50	7.00—8.00
Secondary	685,651	26.4	-38,951	-589	381—417	45-50	8.00—9.00
Total	1,768,137	21.8	18,206	132,033			

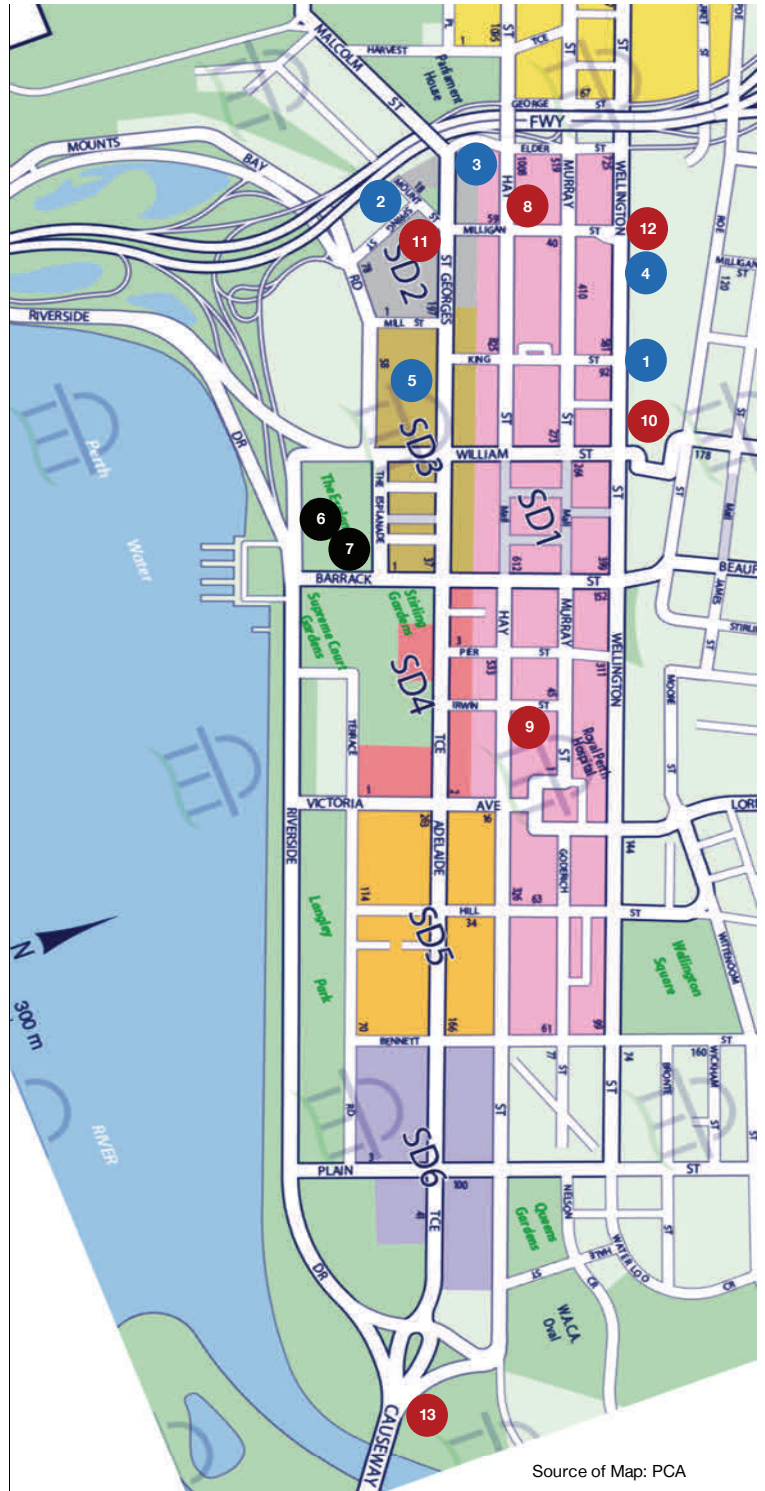
Source: Knight Frank Research/PCA

MAJOR OFFICE SUPPLY

- 1 KS1 (Kings Square)*, 376 Wellington St - 22,612m²
DEXUS & DWPF - complete - seeking pre-commitment
- 2 Capital Square, 98-124 Mounts Bay Rd - 48,484m² [Woodside]
AAIG - mid 2018 - 100% committed
- 3 999 Hay Street - 10m760m² [GHD]
Leighton / Broad Construction Services
- 4 KS4 (Kings Square)*, Wellington Street - 12,000m² [HBF]
HBF - Complete - 72% complete
- 5 123 St Georges Terrace (Brookfield Place 2) - 33,600m² [Ashurst, Corrs,
Deloitte, Brookfield, Westfarmers] - Complete - 63% committed
- 6 Elizabeth Quay - 13,000m² excluding 70,000m² Chevron Site
Leighton / Broad Construction Services
- 7 Crn Barrack St & The Esplanade - 70,000m² [Chevron]
Chevron - DA Pending
- 8 950 Hay St (old Melbourne Hotel site) - 10,000m²
Oakesfield Pty Ltd - DA received (Mooted)
- 9 480 Hay St - 34,000m² - Seeking Tenants
FES Ministerial Body - DA received
- 10 Perth City Link * - Circa 120,000m² exclusive of Kings Square
Mirvac/Leighton development consortium
- 11 239 St Georges Tce (Bishops See no.2) - 46,000m²+
Brookfield/Hawaiian - Mooted
- 12 KS5 (Kings Square) * - 38,000m²
Seven Entertainment - Mooted
- 13 Waterbank, near The Causeway - 17,000m²
Lend Lease / MRA - Initial site works

- Completed / Under Construction
- Dev Approved / Confirmed / Site Works
- Mooted / Early Feasibility

NB. Dates are Knight Frank Research estimates
Office NLA quoted
Major tenant precommitment in [brackets] next to NLA
Full refurbishment
* Mirvac/Leighton awarded the Perth City Link development contract excluding the Kings Square precinct.
KS 1 to 5 are being developed by Leighton / Seven Group.



Source of Map: PCA

TENANT DEMAND & RENTS

Net Absorption

Since January 2013, the Perth CBD market had experienced negative net absorption, with cumulative net demand of negative 152,602m². However, this extended period of negative absorption was broken with a positive 35,447m² recorded in January 2016 followed by a negative 17,241m² result in the six months to July 2016.

The extended period of negative net absorption was attributed to the increase in sublease and direct space available in the Perth CBD as companies continued to downsize. In turn the recent positive outcome can be attributed to the portion of new developments reaching completion and already bring pre-committed totalling approx. 70%.

The negative outcome for the current period is wholly due to the lower graded stock with Prime grade assets recording positive 650m² and Secondary grade assets remaining negative at 17,891m². This negative result is an impact of the flight to quality trend currently seen in the CBD market. Tenants are seizing the opportunity to relocate into better quality space and move out of their B and C grade accommodation into a Premium or A grade building.

Breaking down the Prime absorption, Premium Grade assets recorded negative 1,618m² for the six months to July 2016. The majority of net absorption coming from A Grade assets at 2,268m². B Grade and C Grade were both negative totalling 17,123m² and 768m² respectively.

Vacancy

The Perth CBD office vacancy lifted to 21.8% as at July 2016, an increase, of 2.2 percentage points, from the January 2016 figure of 19.6%. A total of 385,303m² of vacant office space is available across the Perth CBD. Vacant office space in the CBD has steadily increased year on year from a low of 47,863m² in January 2012.

All asset grades recorded an increase in vacancies with the exception of D grade assets which remained unchanged. The largest volume of space vacant is in A and B grade buildings with 144,661m² (38% of the total vacancy) and 136,498m² (35% of the total vacancy) respectively. The Prime grade vacancy has lifted from 17.4% in January 2016 to 18.8%, while Secondary vacancies lifted from 22.9% to 26.4%.

Over the past year, prime vacant space

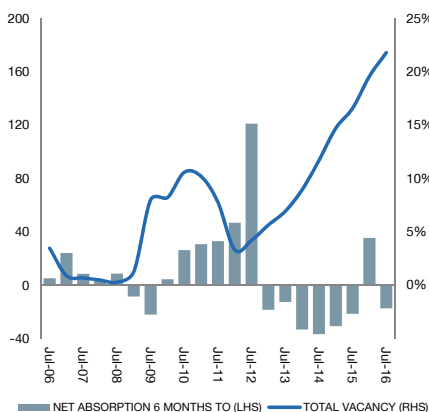
increased by 59% compared to secondary vacant space which increased by 27%.

Sublease space continues to be a factor within the Perth CBD office market. The sublease vacancy is sitting at 4.3%, a total of 75,550m². This has gradually increased since January 2012 where the Perth CBD had a sublease vacancy of only 0.5% (6,684m²).

The current Perth CBD office market is allowing tenants the opportunity to seek better quality space and obtain greater incentives and in turn reset their passing rentals. Tenants upgrading from secondary to prime grade properties are ideally looking for small to mid-sized space at competitive rents with longer lease terms and increased incentives. The incentives that tenants are seeking include rent free periods/rebates as well as capital contributions for office fit-outs which in turn minimises the cost for the tenant with the relocation.

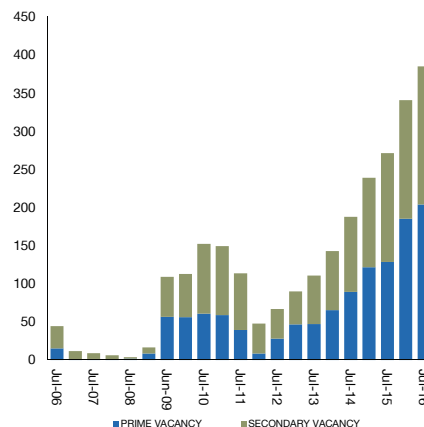
Movement in the market includes Arup signing a seven year lease with a five year option at Level 14, 2 The Esplanade (Exchange Tower) relocating from 836 Wellington Street, West Perth. Also relocating to Exchange Tower is Fujitsu Australia taking 1,309m² and a

FIGURE 2
Net Absorption and Vacancy
(*000m² and %) per six month period



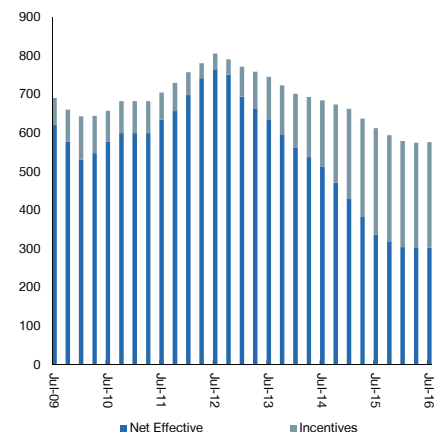
Source: Knight Frank Research/ PCA

FIGURE 3
Perth CBD Historical Vacancy
Prime and Secondary grade (*000m²)



Source: Knight Frank Research/ PCA

FIGURE 4
Perth CBD Prime Office Rents
Avg Net Rents and Incentives (\$/m²)



Source: Knight Frank Research

seven year lease term. Urbis have relocated from 55 St Georges Terrace to 1 William Street, The Quadrant, taking 1,095m² of newly fitted out space for seven years with a five year option.

The Perth CBD office market is seeing tenants relocating from outside market boundaries and expanding into the CBD market as seen with Arup's move. They are also relocating into better quality space with several deals done in Exchange Tower and The Quadrant, both Prime grade buildings and at a longer lease terms with options.

effective) as at July 2016. In dollar figures rents have dropped \$204/m² since the peak in 2012.

The trend in the CBD and to a lesser extent the suburban markets is that the net effective rents are being impacted by the creeping incentive levels. These levels have continued to increase through 2014 and 2015 and are sitting at around 47.5% of lease terms across all grades.

Secondary grade net face rents reached a peak of \$616/m² in July 2012 and have since steadily declined to just under \$400/m² (\$209/m² net effective) currently and are remaining flat due to the lack of demand and increasing variety of options to choose from.

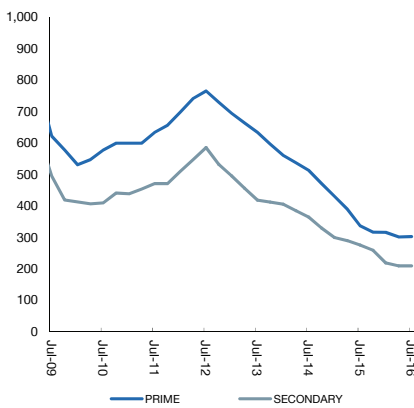
The increased demand for Prime grade space has stabilised the asking rents at the start of 2016 as tenants are taking advantage of incentive levels and relocating to better quality office space.

The quality of available stock to lease is generally of a lower grade and until this stock is absorbed or redeveloped the vacancy rate will remain elevated. However, it is expected that the CBD will see the vacancy rate level off moving into 2017 as no new supply enters the market.

Rental Levels

Perth CBD offices have demonstrated a steady decline in both Prime and Secondary grade rents since the peak in mid 2012. Net face rents in Prime grade assets average \$576/m² (\$302/m² net

FIGURE 5
Perth CBD Office Rents
Prime and Secondary Average Net Effective Rents (\$/m²)



Source: Knight Frank Research

TABLE 2
Recent Leasing Activity—Perth CBD

Address	NLA m ²	Term yrs	Tenant	Lease Type	Date
10 William Street	2,102	10	Central Queensland University	New	Jul-16
150 St Georges Terrace	220	5	Stirling Andersen	New	Jun-16
44 St Georges Terrace	449	8	Ace Insurance	Renew	Jun-16
15-17 William Street	1,288	1	McDermott	Renew	Jun-16
40 St Georges Terrace	127	2	ThoughtWorks Australia	New	Jun-16
	107	4	Palabc Holdings	Renew	May-16
	610	2	Alinta	Renew	Apr-16
1 William Street	1,095	7	Urbis	New	Apr-16
	2,882	10	Lavan Legal	Renew	Mar-16
2 The Esplanade	249	10	Viva Energy Australia	New	Jun-16
	313	5	WT Partnership	New	Jun-16
	1,309	7	Fujitsu Australia	New	Jun-16
	1,301	7	Knight Frank Australia	Renew	May-16
	1,499	7	Arup	New	Mar-16
50 St Georges Terrace	123	5	InFocus/BrainStorm	New	Mar-16
	369	5	Kyushu	Renew	Feb-16
50 St Georges Terrace	380	3	Carlson Wagonlit Australia	Renew	Feb-16
218 St Georges Terrace	206	1	Solution Minds	Renewal	Jan-16

Source: Knight Frank Research

INVESTMENT ACTIVITY & YIELDS

Transaction Activity

Sales activity in the Perth CBD has picked up in 2016 so far with sales transactions totalling approximately \$470 million as at June 2016. This amounts to four transactions, up from 2015's total of three at a value of approximately \$216 million. The volume of transaction each year has dropped from a high of 11 in 2011 amounting to over \$1.1 billion worth of Perth CBD office assets transacting. Interestingly 2013 had a lower number of assets changing hands, eight, but amounted to a higher dollar value of \$1.34 billion combined.

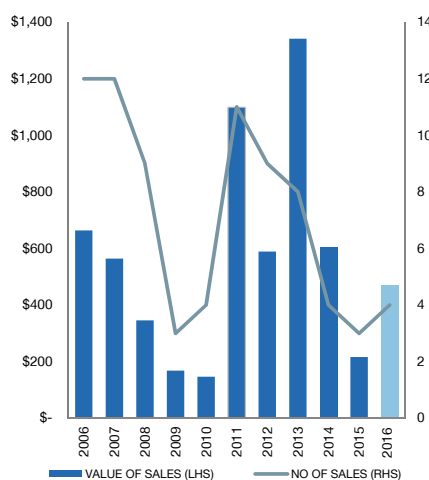
The end of 2015 saw a number of negotiations commence that resulted in the sale of 190 St Georges Terrace and 12-14 The Esplanade. These two transactions totalled \$115.2 million, (\$51 million and \$64.2 million respectively). The sale of 190 St Georges Terrace was finalised in late December 2015, purchased by Credit Suisse REIM at a core market yield of 7.39%. The 11 storey office building has a net lettable area of 9,332m² and recently underwent a refurbishment. The CTA Building, located at 12-14 The Esplanade, was sold to Cape Bouvard Investments Pty Ltd. The A-grade office building is a 14 level office building with a NLA of 7,975m² and has a WALE of 3.4 years and traded on a core market yield of 8.1%.

The first quarter of 2016 confirmed the sale of 219 & 221 St Georges Terrace, sold for \$190.4 million to a private

Chinese investment company on a core market yield of 8.2% and vacancy of 23% at the time of sale. The vendor was the Insurance Commission of Western Australia (ICWA) and represents the third significant divestment from their sales campaign that commenced in mid 2015. More recently, ICWA sold another asset; 167 St Georges Terrace for a sale price of \$87 million to Zone Q; the Australian subsidiary of Chinese development giant JiaHe JianAn Group, which transacted in July 2016. The fourth transaction in a year for ICWA is an 11 level office building with 13 tenancies, no vacancy at the time of sale, sold with a WALE of 3.7 years and on a core market yield of 6.2%.

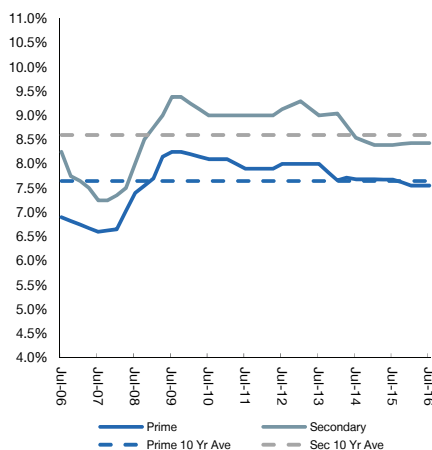
The Perth CBD office market has seen four transactions in 2016 thus far to the value of \$470 million

FIGURE 6
Perth CBD Sales Activity 2006–2016
(\$ million) Sales Value and Number



Source: Knight Frank Research

FIGURE 7
Perth CBD Office Yields
Prime and Secondary Core Market Yields



Source: Knight Frank Research

TABLE 3
Recent Sales Activity—Perth CBD

Address	Price \$ mil	Core Market Yield (%)	NLA m ²	\$/m ² of NLA	WALE yrs	Vendor	Purchaser	Sale Date
167 St Georges Tce	87.00	6.20	10,585	8,219	3.7	ICWA	Zone Q ~	Jul-16
2 The Esplanade *	110.00	7.39	34,432	6,389	3.3	Unlisted Syndicate^	Primewest	Mar-16
81 St Georges Tce	82.95	7.10	12,225	6,785	9.3	Nick Tana	ARA Group #	Mar-16
219 & 221 St Georges Tce	190.40	8.20	31,434	6,057	4.7	ICWA	Perth Upper China Hotel	Feb-16

Source: Knight Frank Research
#Singaporean Company

*50% share of leasehold interest
~ Mainland Chinese develop

ICWA—Insurance Commission of WA

^formerly controlled by Novion Property Group

Primewest purchased a 50% share of Exchange Tower, located at 2 The Esplanade amounting to a net lettable area of 34,432m² for \$110 million with the other 50% share of the 41 level office tower owned by AMP Capital since December 2011.

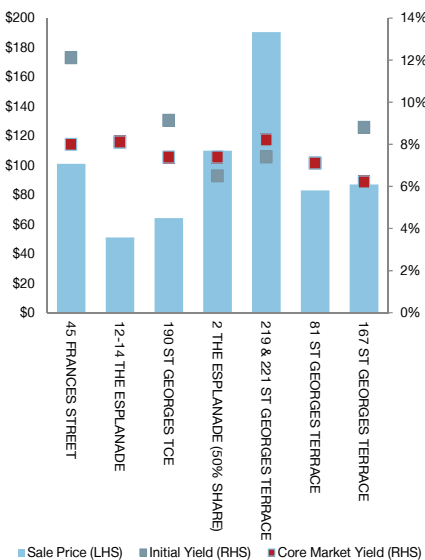
The increased interest in office investments in the Perth CBD in 2016 will continue into the second half of 2016 and 2017, with further litmus tests being 226 Adelaide Terrace and 1 Nash Street, known as the WorkZone building, which are currently on the market for sale. Investors entering the market may face challenges in the short term but when looking at the bigger picture will be able to ride out the current market conditions and benefit from the cyclical challenges.

The recovery in Perth CBD office investment sales in the year to June 2016 compared to the previous financial year indicates a growing confidence by investors that the market has reached the bottom of the cycle. A growing number of Asian entities are related to the above mentioned transactions.

The investment market has remained steady with Prime yields remaining around 7.00%-8.00%. Secondary yields have fallen away slightly, ranging between 8.00%-9.00%. It is expected that yields will remain tight with the possibility of further tightening throughout the next year as interest rates remain at record lows.

Asian interest is picking up in the investment market, with two recent transactions being to Chinese groups and one to a Singaporean based fund manager

FIGURE 8
Perth CBD Transaction Yields
2015 & 2016



Source: Knight Frank Research

Outlook

- Falling rents and higher incentives are providing tenants with some favourable leasing conditions.
- More non-CBD tenants will continue to look to secure CBD office accommodation, taking advantage of competitive/attractive deals.
- Developers continue to strive to secure tenants before commencement of construction works amidst the increasingly challenging office environment.
- Incentives have risen sharply to around 45-50% of the net rent and is expected to remain high as vacancy levels rise.
- Tenant enquiry levels indicate net absorption will remain soft during 2016 and into 2017.
- With the high number of office buildings reaching completion late 2015 and early 2016 it is expected new developments are highly unlikely in the short term as the market will take time to absorb new the supply.
- Based on the pending vacancies as a result of tenant relocation, and assuming on-going soft demand in the short term, vacancy is expected to remain above 20% for the remainder of 2016 and into 2017.
- Several developers have restructured development plans, shifting from office developments to building residential and hotel towers due to the current demand for residential and weakening office market in the Perth CBD.
- Developers will seek a good level of pre-commitment before moving into the construction phase.
- Average prime core market yields are estimated to range between 7.00% and 8.00%, with only the long WALE, prime assets expected to show any material firming moving forward.

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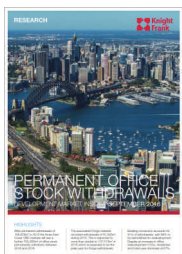
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