RESEARCH

PERTH CBD

OFFICE MARKET OVERVIEW SEPTEMBER 2014

HIGHLIGHTS

Although vacancy is increasing, leasing activity is being stimulated by tenants taking advantage of the competitive rental rates and incentives on offer.

Prime grade net incentive levels have risen to circa 25% which is expected to favour tenant migration to higher quality premises and into the CBD.

There were three major office transactions within the Perth CBD during the first half of 2014, totalling $569.5 million.

KEY FINDINGS

The Perth CBD vacancy rate increased to 11.8% (188,536m^2) as at July 2014 (PCA).

Approximately 169,080m^2 of office supply is currently under construction in the Perth CBD.

Tenant demand remains soft, though a pickup is expected in 2015.

Offshore investors continued to target Perth office assets.

MATT WHITBY
Head of Research & Consulting

SUPPLY & DEVELOPMENT

The effects of a soft Perth CBD leasing market during 2013/14 have materialised with negative net absorption of –70,626m^2 recorded for the twelve months to July 2014, resulting in a rise in the vacancy rate to 11.8%.

Office space in the Perth CBD increased by 8,195m^2 (0.51%) during the six months to July 2014, with a further 18,507m^2 forecast to become available over the second half of the year (see pg. 3 supply map for further details). The bulk of new supply is due for completion in 2015 and comprises 154,150m^2 of NLA. In total, 169,080m^2 of supply is currently under construction and due for completion over the next 18 months. Of this supply, 96,265m^2, or 57% has been pre-committed. As a result, 72,815m^2 of office space will be vacant upon completion unless further pre-commitments are secured thus adding further downside risk to Perth's expected vacancy. Buildings currently under construction equate to an increase in CBD stock of 10.5%, a large portion of which will be made up at the Kings Square development. KS1-4 will encompass 61,172m^2 of NLA, with 34,925m^2 of this space having already been pre-leased to Shell, John Holland and HBF.

A further 71,500m^2 has been granted approval and is forecast to be completed by 2018, which includes the Milligan Square and 98 Mounts Bay Road developments. Beyond this, around 133,719m^2 of mooted projects are in the pipeline, with a further 337,000m^2 of commercial space anticipated to come online in the longer term, including Elizabeth Quay, Perth City Link and the Waterbank development.

Sub-lease/Backfill

Limited backfill space has entered the market over the past six months due to low levels of new supply, however, backfill is likely to make an impact in late 2014 and 2015 as new developments reach completion. The latter part of 2014 will see Aurecon's move to 861 Hay Street leaving 5,144m^2 of backfill space at 256 Adelaide Terrace. In mid-2015, the West Australian State Government will consolidate their offices to the Treasury Building, at 58 Barrack Street, which will see Crown Law and the Department of the Attorney General relocate from Westralia Square at 141 St Georges Terrace making 20,000m^2 of backfill available. However, with a lease expiry in 2020 at 141 St Georges Terrace, the State Government is expected to reallocate the majority of backfill to other internal departments. Additional backfill is anticipated when Legal Aid relocate from 55 St Georges Terrace to 32 St Georges Terrace (4,000m^2 of backfill), GHD move into 999 Hay Street (4,000m^2), Shell move into KS2 Kings Square (5,500m^2), and HBF (owner occupier) move into KS4 Kings Square (6,500m^2) during the same period. However, it is likely that the backfill left by HBF at 125 Murray Street will be withdrawn from the market for either refurbishment or conversion purposes. Lastly, 5,543m^2 of backfill is expected when Corrs and Deloitte move to 123 St Goerges Terrace in Q4 2015.

TABLE 1
Perth CBD Office Market Indicators as at July 2014

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	931,217	9.7	-37,451	5,602	617—751	25	7.00—8.25
Secondary	673,087	14.6	-33,175	1,495	464—507	25	8.00—9.00
Total	**1,604,304**	**11.8**	**-70,626**	**7,097**			

Source: Knight Frank/PCA

MAJOR OFFICE SUPPLY

1. 861 Hay St - 10,947m² [Aurecon]
Perth Diocese - Q4 2014 - 50% committed

2. 565 Hay St # - 7,560m²
Perth Diocese - Q4 2014 - seeking pre-commitment

3. Treasury Building - 30,196m² [WA Gov't]
Mirvac / Keppel REIT consortium - Q2 2015 - 100% committed

4. 32 St Georges Tce # - 15,045m² [Legal Aid]
Private - Q2 2015 - 40% committed

5. 999 Hay St - 10,160m² [GHD]
QUBE - Q2 2015 - 59% committed

6. KS2 (Kings Square)*, 376 Wellington St - 19,425m² [Shell]
DEXUS & DWPF - Q2 2015 - 100% committed

7. KS1 (Kings Square)*, 376 Wellington St - 22,247m²
DEXUS & DWPF - mid 2015+ - seeking pre-commitment

8. KS3 (Kings Square)*, 376 Wellington St - 6,500m² [John Holland]
DEXUS & DWPF - mid 2015+ - 100% pre-committed

9. KS4 (Kings Square)*, Wellington St - 13,000m² [HBF]
HBF - late 2015 - 69% committed

10. 123 St Georges Tce (Brookfield Place Sth) - 34,000m² [Corrs, Deloitte, Brookfield] - Brookfield - Q4 2015 - 41% committed

11. Veil 253, 253 St Georges Tce - 3,577m²
Primewest - Q4 2015 - seeking pre-commitment

12. 47-59 Milligan St (Milligan Square) - 21,000m²
Georgiou - mid 2016 - seeking pre-commitment

13. Capital Square, 98-124 Mounts Bay Rd - 50,500m² [Woodside] - H.O.A
AAIG - mid 2018 - 100% committed

14. Crn Barrack St & The Esplanade - 60,000m² [Chevron]
Chevron - DA Pending

15. 100 Murray St # - 4,000m²
AWD Diversified - seeking pre-commitment

16. 950 Hay St (old Melbourne Hotel site) - 11,219m²
Oakesfield - New DA Pending

17. 239 St Georges Tce (Bishops See no.2) - 30,000m²+
Brookfield/Hawaiian - seeking pre-commitment

18. KS5 (Kings Square) * - 38,000m²
Seven Entertainment - DA Pending

19. 480 Hay St - 35,000m²
BGC - DA Pending - seeking pre-commitment

20. 36 St Georges Tce - 16,500m²
Uniting Church of Australia - DA Pending

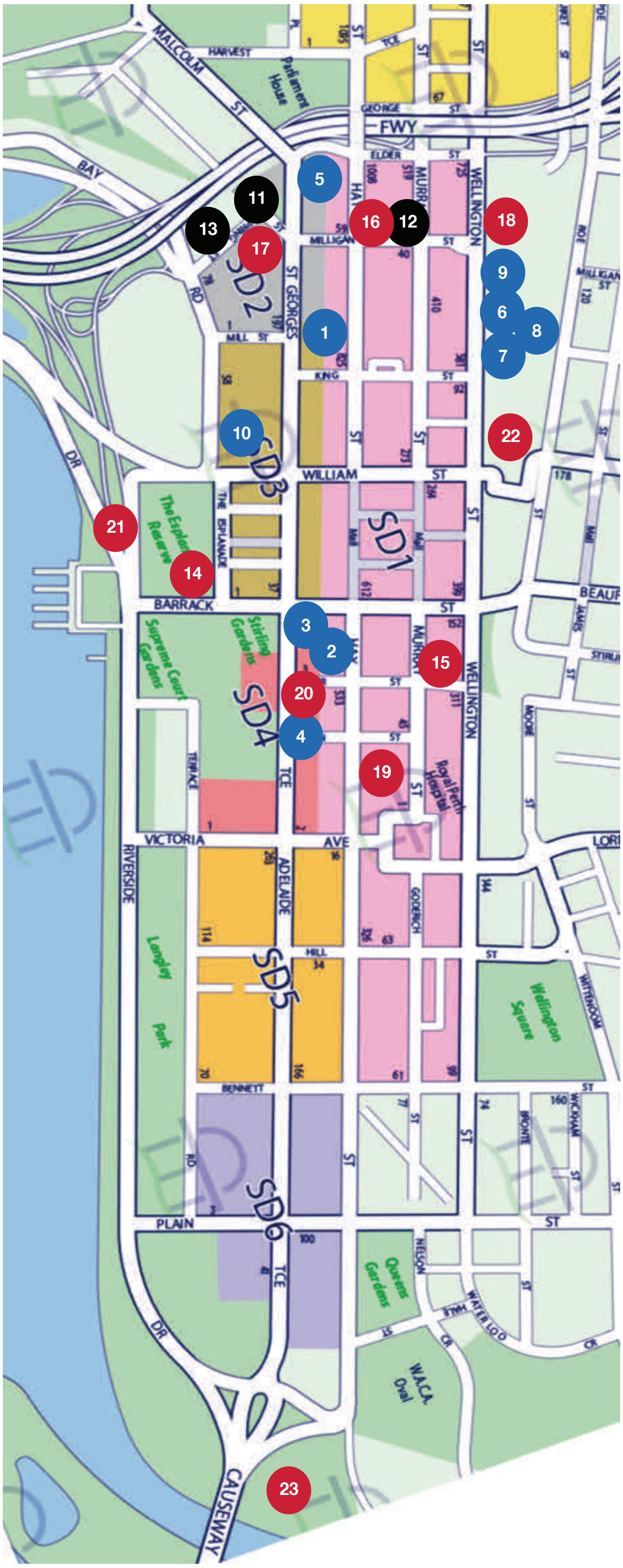
21. Elizabeth Quay - 140,000m² excluding 60,000m² Chevron site
Leighton / Broad Construction Services

22. Perth City Link * - Circa 120,000m² exclusive of Kings Square
Mirvac/Leighton development consortium

23. Waterbank, near The Causeway - 17,000m²
Lend Lease / MRA - Initial site works

- Under Construction (blue)
- DA Approved / Confirmed / Site Works (black)
- Mooted / Early Feasibility (red)

NB. Dates are Knight Frank Research estimates
Office NLA quoted
Major tenant precommitment in [brackets] next to NLA
Major refurbishment
* Mirvac/Leighton awarded the Perth City Link development contract excluding the Kings Square precinct.
KS1-5 are being developed by Leighton / Seven Group.



TENANT DEMAND & RENTS

The July 2014 release of data from the PCA saw the total vacancy rate for the Perth CBD increase to 11.8%, up from 9.0% in January 2014. The key drivers of the vacancy increase were soft tenant demand and business contraction. Increases in vacancy were experienced within both prime and secondary assets. Prime-grades recorded a rise from 7.2% to 9.7% to a total vacancy of 90,158m^2. Within the prime-grade, vacancy in Premium buildings increased for the first time in 18 months rising from 1.4% in January 2014 to 3.9% in July 2014, representing an 8,020m^2 rise in available NLA. The vacancy within A-grade buildings increased for the fifth consecutive half year period, rising from 10.2% in January 2014 to currently sit at 12.7%.

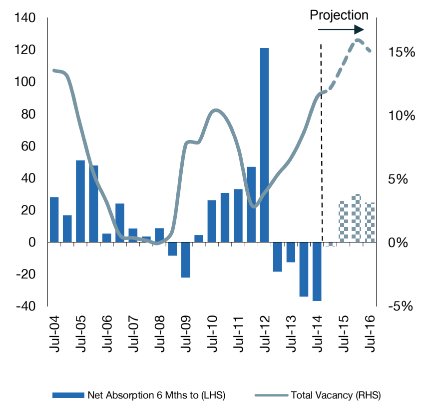
The secondary market is now experiencing the highest vacancy rate since January 2005, totalling 14.6% up from 11.5% in January 2014. Increases were recorded across all secondary grades. B and C grade buildings are now showing vacancy rates of 13.1% (up from 11.3%) and 16.3% (up from 12.3%) respectively. The vacancy within D grade buildings spiked over the past six months from 7.4% to 57.6% (up 4,073m^2), a result of the flight to quality that is evident in the market. Rising vacancy levels are adding to the pressure on owners to readjust rental levels in accordance with prevailing market conditions, thus providing tenants with some favourable leasing options within higher quality buildings. Furthermore, larger incentives are creeping into the market in the form of rent free periods and capital contributions for office fit-outs, which are minimising the costs associated with tenant relocation.

Increases were most pronounced in the direct vacancy over the past six months, with the rate rising from 6.3% to 9.0% to currently total 144,772m^2. The direct vacancy is now at its highest recording since January 2005. Sublease space continues to be a major factor within the Perth CBD office market. Approximately 37,000m^2 of sublease space has entered the market since the mining downturn in 2012. The majority of this space (30,660m^2) became available during the 12 months to January 2013 which saw the sublease vacancy increase from 0.5% to 2.4% of total available stock. During the past 18 months, the rate at which sublease space has entered the market has significantly declined. The sublease vacancy increased during the six months to July 2014, albeit marginally (843m^2) and currently accounts for 2.7% of total stock.

Net Absorption

The Perth CBD market recorded negative net absorption of 70,626m^2 over the financial year to July 2014 as company contraction and tenant relocation made its impact. This was made up of negative 33,938m^2 in the 6 months to January 2014 and negative 36,688m^2 during the current period. All building grades experienced negative absorption during the 6 months to July 2014 demonstrating the pace at which vacancy is outstripping demand. Prime grade absorption totalled negative 18,500m^2 and accounted for 50.4% of the total. Premium grade assets recorded negative 6,140m^2 of absorption following two consecutive half year periods of positive results. A grade on the other hand saw negative absorption of 12,360m^2 reflecting a mild improvement from the negative 21,296m^2 recorded to January 2014. Further negative absorption was experienced in the secondary market (-18,188m^2) which was fairly evenly spread between B, C and D graded assets. It is anticipated that negative net absorption levels will continue through to 2015 under the weight of subdued tenant demand. Thereafter, net absorption levels are expected to improve with a number of large pre-lease deals due to commence.

FIGURE 2
Net Absorption and Vacancy
('000m^2 and %) per six month period

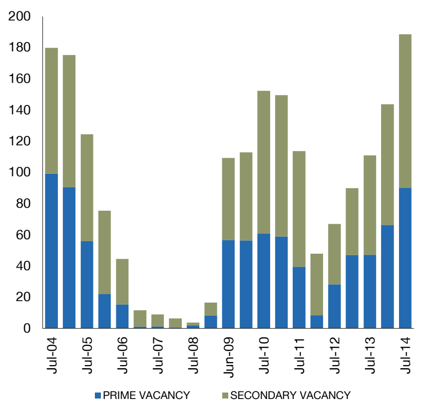


Source: Knight Frank

Vacancy

A combination of persisting soft tenant demand, as well as a significant amount of forecast new supply due for completion in 2015, will cause the vacancy rate to increase over the next 12 to 18 months. The vacancy is expected to rise above 16% by the end of 2015, before beginning to show some improvement through the 2016 calendar year. A significant reduction in the level of new supply and improving tenant demand conditions is expected to support the vacancy rate steadily falling through to 2018. However, It is unlikely that a recovery in the vacancy rate will be assisted by stock withdrawals for conversion purposes given the current level of proposed residential apartment and hotel developments within the Perth market.

FIGURE 1
Perth CBD Historical Vacancy
Prime and Secondary grade ('000m^2)



Source: Knight Frank

Tenant Demand

Tenant demand remains soft with businesses looking to improve cost efficiencies and consolidate their office accommodation. However, some activity is being stimulated by tenants taking advantage of the competitive rental rates and incentives on offer. PCA figures show tenant demand was weakest in Perth's A-grade market which recorded 77,506m^2 of vacant space as at July 2014. Despite soft leasing conditions, certain tenants have continued to make decisions for their longer term accommodation needs. This is demonstrated by WHL Legal Pty Ltd recently signing a seven year lease for 639m^2 of space at 218 St Georges Terrace.

Conditions in the office leasing market over the past 18 months have reflected the changing nature of WA's economy in the post-mining investment boom period. While leasing activity is partly being supported by the State's oil and gas industry, the focus has now shifted from mining related tenants to population growth driven tenants, such as education, accounting and legal services.

In Q2 2014, Woodside Petroleum announced that it had entered into an agreement to pre-lease 50,500m^2 at 11 Spring Street, which form part of the proposed development at 98-124 Mounts Bay Road (the former Emu Brewery site). The proposed $1 billion development, which will include a 31-level office tower, a 41-storey apartment building, and a hotel comprising 120 rooms, has been seeking pre-commitment since the project was abandoned in 2009 due to the previous owner being under receivership. Site clearing work began in June 2014 and if the proposal goes ahead, the project will be completed by Q2 2018. Woodside's relocation to 98 Mounts Bay Road would see approximately 42,000m^2 of backfill space enter the market at 240 St Georges Terrace (Woodside Plaza). This is in addition to the 5,543m^2 of backfill made available when Corrs and Deloitte's relocate to 123 St Georges Terrace (Brookfield Place South) during the fourth quarter of 2015.

Rental Levels

Downward pressure on prime and secondary rents has continued as increasing levels of vacancy made its impact. Net face rents in Prime-grade buildings have softened to an average of $684/m^2 (vs. $701/m^2 in Jan-14) representing a -2.4% fall during the six months to July 2014. However, incentives have risen to around 25% of the net rent over the term of the lease (vs. 20% in Jan-14). On a net effective basis, this has seen a fall in rents in the order of –19.0% over the past 12 months. There were a number of deals during the past six months, however, that exceeded the prime average rent, including Itochu's lease at 221 St Georges Terrace in July 2014 for 534m^2 of NLA at a net rent of $725/m^2 with a 15% incentive in place.

The secondary market continues to face strong competition as prime leasing options become comparably cheaper. Average secondary net face rents have decreased approximately -4.1% to an average of $486/m^2 compared to $507/m^2 six months ago, with net incentives 25% (vs. 20% in Jan-14). This is the lowest average Secondary net face rent figure recorded since July 2007. Going forward, it is expected that incentives will remain elevated through to late 2015 as vacancy levels will increase when new supply enters the market.

> "Woodside is believed to have entered into an agreement to pre-lease 50,500m² at 98-124 Mounts Bay Road"

TABLE 2
Recent Leasing Activity—Perth CBD

Address	NLA m²	Face Rent $/m²	Term yrs	Incentive (%)`	Tenant	Start Date
218 St Georges Terrace	639	450 n	7	20-25	WHL Legal Pty Ltd	Sep-14
108 St Georges Terrace	1,764	665 n	undis	10-15	Pioneer Credit	Jul-14
221 St Georges Terrace	534	725 n	5	15	Itochu	Jul-14
55 St Georges Terrace	545	580 n	5	10-15	Minister for Work	Jun-14
225 St Georges Terrace	715	700 n	7	25-30	Aquila	Jun-14
140 William Street	1,250	600 n	10	15-20	Red Cross	Jun-14
225 St Georges Terrace	1,130	675 n	7	20-25	Marsh	May-14
150 St Georges Terrace	412	625 n	5	15-20	Talent International	May-14
252 Adelaide Terrace	480	550 n	5	0	Consulate General of Malaysia	Apr-14

`estimated incentive calculated on a straight line basis
Source: Knight Frank

INVESTMENT ACTIVITY & YIELDS

Following an active investment market in 2013 that saw more than $1.34 billion worth of Perth CBD office assets change hands, sales activity during the first six months of 2014 has moderated. It should be noted that the significant transactional volumes experienced in 2013 can be predominantly attributed to the timing of prime stock coming to market. In particular, Raine Square and Bankwest Place at 300 Murray Street, KS1-3 at Kings Square on Wellington Street, and Allendale Square at 77 St Georges Terrace, all of which sold in the first half of 2013. Similar levels of buyer interest are expected during the remainder of 2014 should any prime office assets with solid lease covenants and low CAPEX requirements come to market.

International investors continue to target Perth office assets, accounting for two of the three major transactions (>$10 million) which saw $569.5 million injected into the Perth CBD market this year. In February 2014, listed Singaporean real estate company, Hiap Hoe, purchased 130 Stirling Street from a Charter Hall syndicate for $90 million in the northern fringe of the Perth CBD reflecting an initial passing yield of 7.92% (core market 8.26%). The seven storey complex, which is situated on a 3,055m^2 site and comprises 12,349m^2 of NLA, includes three ground floor retail units, four upper levels of office accommodation and 236 parking bays. The sale reflects a building rate of $7,288/m^2 and a land rate of $29,460/m^2.

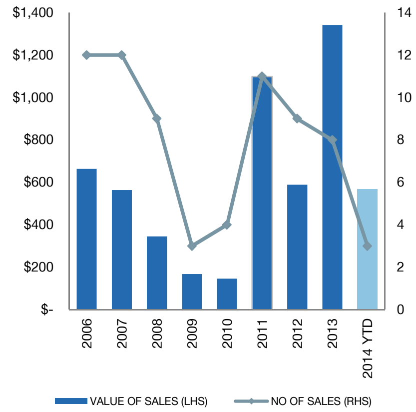
The second major transaction occurred in April 2014 when offshore investor, Far East Organisation, entered into a contract to purchase the Septimus Roe office tower at 256 Adelaide Terrace for $91 million, reflecting an initial yield of 11.0%. Septimus Roe is a 19 storey, B-grade office building, originally constructed in 1978. The building has 17,247m^2 of office accommodation, 480m^2 of retail space and 123 car bays on the basement levels. The complex, which is situated on a 3,182m^2 site, was 90.3% occupied at the time of sale, reflecting a WALE by income of 1.8 years. The sale reflects a core market yield of 8.6% which falls substantially below the passing yield, reflecting the estimated capex requirements of approximately $10 million over years one and two and potential negative rental reversion on short term lease expires.

The largest transaction to occur during the 2014 YTD was the 50%, related party sale of QV1 at 250 St Georges Terrace. The half share in the premium grade landmark, 42 level office tower, which includes a 5 1/2 level car parking station and retail plaza, sold for $388.5 million in June 2014 reflecting a core market yield of 7.20% (office tower, basement car park and retail only). Investa Commercial Property Fund (ICPF) purchased the property from Investa Property Trust in what is the largest CBD transaction since April 2013. QV1 is 100% leased and includes major tenants Chevron (40.3% of NLA), Worley Parsons, Clayton Utz, King and Wood Mallesons, Herbet Smith Freehills and Allens Linklaters. The asset sold with a WALE by income of 7.7 years reflecting a rate of $11,372/m^2 on NLA (office tower, basement car park and retail only).

FIGURE 3

Perth CBD Sales Activity 2006—2014

($ million) Sales Value >$10 million and Number



Source: Knight Frank

Most buyer types favour modern, prime grade assets with long WALE's and minimal CAPEX requirements, however some offshore and institutional investors are seeking value add opportunities. At present, 220 St Georges Terrace and 125 Murray Street are listed for sale, both offering value add opportunities. Forthcoming investment opportunities include the Colonial First State Global Asset Management-run Private Property Syndicate's 50% share in Exchange Plaza at 2 The Esplanade. Colonial's half stake in the premium tower is expected to attract strong interest from investors who missed out on prime assets that sold in 2013. The buyer interest in the Perth CBD market remains strong from offshore investors, institutions and syndicates which is expected to continue.

TABLE 3

Recent Sales Activity—Perth CBD

Address	Grade	Price $ mil	Core Market Yield	NLA m²	$/m² NLA	WALE	Vendor	Purchaser	Sale Date
250 St Georges Terrace	P	388.5	7.20^	61,217	11,372^	7.7	Investa Property Trust	ICPF*	Jun-14
256 Adelaide Terrace	B	91.0	8.56	17,247	5,133	1.8	Aspen Group	Far East Organisation	Apr-14
130 Stirling Street	A	90.0	8.26	12,349	7,288	5.6	Charter Hall#	Hiap Hoe	Feb-14

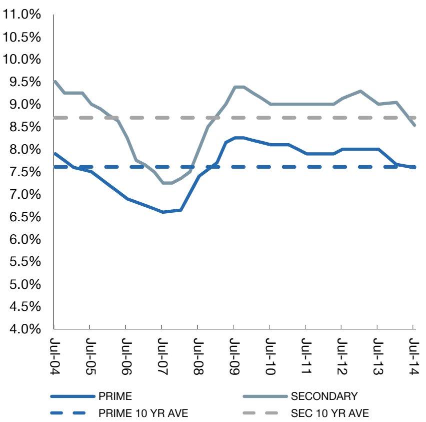
Source: Knight Frank ^ Office tower, basement car park and retail only * Investa Commercial Property Fund # The 130 Stirling Street Trust (CHIF7)

> "Demand for Perth office assets remains strong, though a lack of properties coming to the market has resulted in low levels of sales"

A depreciating Australian dollar saw the attention of offshore investors return to the Perth market during the second half of 2013, and this gained some traction during the first six months of 2014. In addition to the more favourable exchange rate, Perth CBD office yields currently range between 7.00% and 9.00%, whereas in Asia they commonly fall below 4%. As a result, investment opportunities in Perth have been very attractive from an International buyer's perspective, especially when investment opportunities in many parts of Asia are currently quite limited.

Investment demand for office assets remains positive though a lack of stock coming to the market has resulted in low levels of sales. Knight Frank expects more sellers to enter the market during the remainder of 2014, which is expected to attract strong interest from local and international investors. An increase in competition and demand for prime assets has seen average prime yields show further yield compression over the past six months. This has been supported by the lack of well leased prime assets listed for sale. Average prime yields are estimated to range between 7.00% and 8.25% and are now trading just below their ten year average, reflecting 7bps of tightening over the past half year period. Average secondary yields range between 8.00% and 9.00%. Further yield compression is expected in the near term, assisted by strong investment demand in a market characterised by limited buying opportunities.

FIGURE 4
Perth CBD Office Yields
Prime and Secondary Core Market Yields with Averages



Source: Knight Frank

An artists impression of 999 Hay Street which has been 59% pre-leased to GHD—currently under construction and due for completion in Q2 2015

Outlook

- Forecasts from the Department of Treasury indicate that the West Australian economy will grow by 2.75% during 2014/15 .
- Tenant enquiry levels indicate net absorption will remain soft during H2 2014, following the strongly negative net absorption of –70,626m^2 recorded over the past twelve months.
- Encouraging signs exist that tenant demand will likely gain momentum in 2015 as low interest rates start to gain some traction within the State's economy.
- Falling rents and higher incentives are providing tenants with some favourable leasing conditions which should continue for the next one to two years.
- With an abundance of prime leasing options available within the market, it is expected that prime incentives will remain at levels similar to secondary for the next six to twelve months. This is expected to favour smaller tenant's migration into higher quality office space, and non CBD tenants into the CBD.
- Investment demand is expected to remain strong with offshore buyers and high net worth individuals seeking high-yielding assets.
- Investors will continue to favour assets with long WALE's and low CAPEX requirements to de-risk income streams.
- Value add opportunities will also draw attention from investors seeking fundamentally good buildings that have some capex and vacancy risk.
- Following the formalisation of the next round of construction to come online in 2015, the Perth CBD is somewhat exposed to further downside risk. As this space is not available for another 12 months, the rise in vacancy will not be significant in the short term.

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