- *WA economy continues to grow strongly amid stronger national recovery*
- *Leasing market beginning to pick up with smaller deals driving activity*
- *Investment activity rising reflecting investors' confidence in Perth*

Knight Frank

knightfrank.com/research

Perth CBD Office

Market Report, March 2021

ACTIVITY RISING AMID SIGNS OF CONFIDENCE IN PERTH

Investment activity in beginning to pick up reflecting investor confidence in Perth's strong economic fundamentals.

20.0% VACANCY

48.3% PRIME INCENTIVES

6.40% PRIME YIELD

"Strong economic fundamentals and sustained demand for premium office space leave the Perth CBD well placed to emerge from the pandemic downturn."

The Key Insights

The overall vacancy rate rose from 18.4% in July 2020 to 20.0% in January 2021 largely driven by an increase in vacancy in the A grade segment, while the premium grade vacancy rate remained stable at 6.8%.

Average prime incentives have increased to 46%-50%. Effective rents fell by 14% in 2020, while face rents have remained relatively stable.

Demand for office space is picking up but larger deals remain fairly limited as tenants assess space requirements. Net absorption fell by 32,991 sqm over the six months to January 2021 driven mostly a decline in the A grade segment.

Investment activity picked up in the December quarter after being largely on hold for most of 2020. Investment volume totalled $232 million in 2020, down 75% on 2019 levels, although volume in Q4 was in line with the 10-year average.

Average prime yields have remained stable over the past six months at 6.40%.

City CBD Office Market Indicators — January 2021

GRADE	TOTAL STOCK SQM	VACANCY RATE %	NET ABSORPTION SQM	NET ADDITIONS SQM	AVERAGE NET FACE RENT $/SQM	AVERAGE INCENTIVE %	EFFECTIVE RENTAL GROWTH % YOY	AVERAGE CORE MARKET YIELD %*
Prime	1,045,584	15.1	-29,512	0	617	46.5-50	-14.1	6.25-6.55
Secondary	752,096	27.0	-3,479	-4,199	394	50-56	-8.0	7.20–7.65
Total	**1,797,680**	**20.0**	**-32,991**	**-4,199**				

Source: Knight Frank Research/PCA *assuming WALE 5.0 years

WA ECONOMY CONTINUES TO GROW STRONGLY

WA economy continues to outperform amid stronger than expected rebound nationally

Growth in the WA economy moderated in the December quarter following a strong rebound in the September quarter. State final demand rose by 1.5% in Q4, after recording 5.5% growth in Q3. In 2020, state final demand in WA rose by 1.2% compared with a 0.3% fall in domestic final demand for Australia.

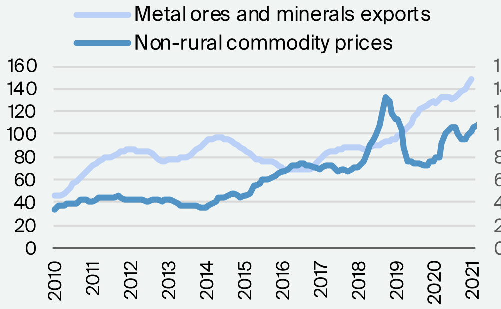
While moderating in the December quarter, household consumption has partly driven the relatively strong performance of the WA economy over the past year. Retail sales rose by 18.4% over the year to January, significantly outpacing the 10.6% growth rate for Australia. Federal and state government incentives for housing construction have also supported growth, underpinning a sharp increase in dwelling investment.

Strong demand for iron ore from China has boosted WA's exports of the commodity. Australia's exports of metal ores (most of which is iron ore) rose by 15% in rolling annual terms over the year to January reflecting both higher export volumes and a strong rally in iron ore prices.

Western Australia is set to continue to perform relatively strongly. Oxford Economics forecasts that gross state product (GSP) will grow by 3.0% in 2021, compared to the 2.5% expansion in gross domestic product (GDP) for Australia. Growth in the state is expected to pick up to 3.65% in 2022, around 1 percentage point higher than the 2.68% growth rate predicted for Australia.

Metal ore exports and commodity prices

12 month rolling sum, $ billion (lhs), index (rhs)



Source: Knight Frank Research, Macrobond

Leasing enquiry picking up with demand concentrated in smaller deals

The strength of the resources sector is generally not translating into stronger demand for office space. This is partly because a lot of the planned resource sector infrastructure investment that would typically drive demand for office space has already been completed.

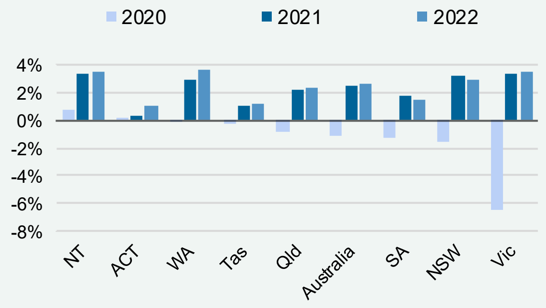
Leasing activity in the Perth CBD has been subdued due to the pandemic, but a recent pickup in enquiry points to improving demand for office space. Demand has been largely concentrated in deals for 500 sqm or less, with 1,000 sqm+ deals remaining limited as tenants review their requirements for office space. Total net absorption fell by 32,991 sqm over the six months to January 2021, largely driven by a 29,666 sqm decline in net absorption in the A grade segment. The secondary market accounted for the remainder of the fall, while net absorption in the premium grade segment rose.

Overall demand for office space is likely to pick up in the near-term. However, there is an increasing divergence in demand among the segments and individual assets, with corporates chasing premium stock in the CBD as well as stronger demand for space in CBD fringe and suburban areas. By contrast, demand for lower A grade and secondary stock in the CBD remains limited.

Demand for office space could be boosted by the recovery in oil and gas prices from the sharp declines seen in 2020. The turnaround in prices may lead some energy companies to proceed with LNG projects that had previously been shelved, which could in turn have positive flow on effects to engineering-related office employment in the Perth CBD.

GSP and GDP

Percent change



Source: Knight Frank Research, Oxford Economics

INCREASE IN VACANCY CONTAINED BY LIMITED NEW SUPPLY

Increase in vacancy concentrated in A grade stock, while premium vacancy remains steady

The Perth CBD vacancy rate increased from 18.4% in July 2020 to 20.0% in January 2021, driven by a 4.7 percentage point increase in vacancy for A grade stock to 20.5%. By contrast, the premium vacancy rate remained unchanged at 6.8%. The overall prime vacancy rate rose from 12.2% to 15.1%, while secondary market vacancy increased by 0.1 percentage point to 27.0%. The increase in vacancy was driven by the fall in net absorption with no new developments completed in the six months to January.

Sublease vacancy rose to 1.5% of total CBD office stock in January 2021, up from 0.9% in July 2020. A grade stock accounted for 52% of the increase in sub-lease space, while the premium segment made up a further 24%.

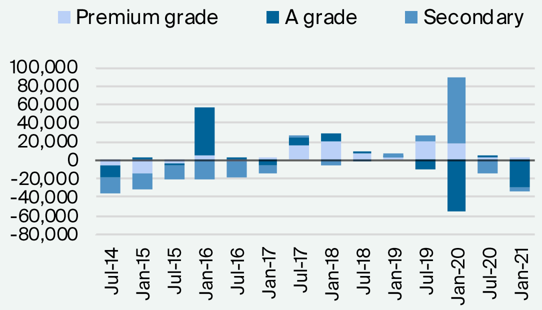
Vacancy likely to rise further but increase will be contained by limited new supply

Subdued net absorption will likely see the vacancy rate rise a little further to around 22% in 2021. Stronger demand for office space as employment growth strengthens and people continue to return to offices is likely to drive a gradual but steady decline in the vacancy rate from 2022 onwards.

The supply pipeline is fairly limited. Capital Square Tower 2 is expected to deliver 25,200 sqm of office space towards the end of this year, while several refurbishments are expected to add a combined 17,025 sqm. Chevron's new headquarters at One The Esplanade (50,000 sqm of office space) is due to be completed in H2 2023. Chevron is understood to have pre-committed around 42,000 sqm of this space.

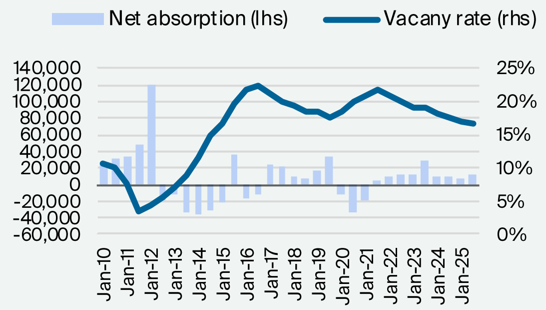
Further out, the Perth Convention Centre Precinct development at 21 Mounts Bay Road is expected to deliver 20,000 sqm of office space in the second half of 2025.

Net absorption
By grade, sqm



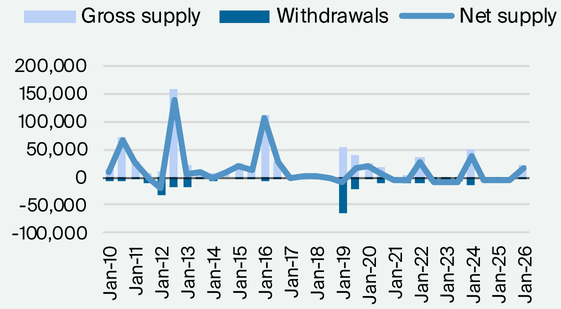
Source: Knight Frank Research, PCA

Net absorption and vacancy rate
Sqm (lhs), per cent (rhs)



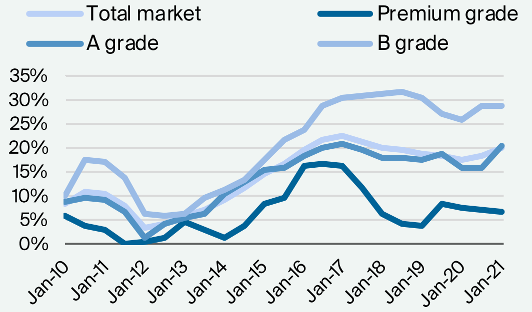
Source: Knight Frank Research, PCA

Supply and withdrawals
Sqm



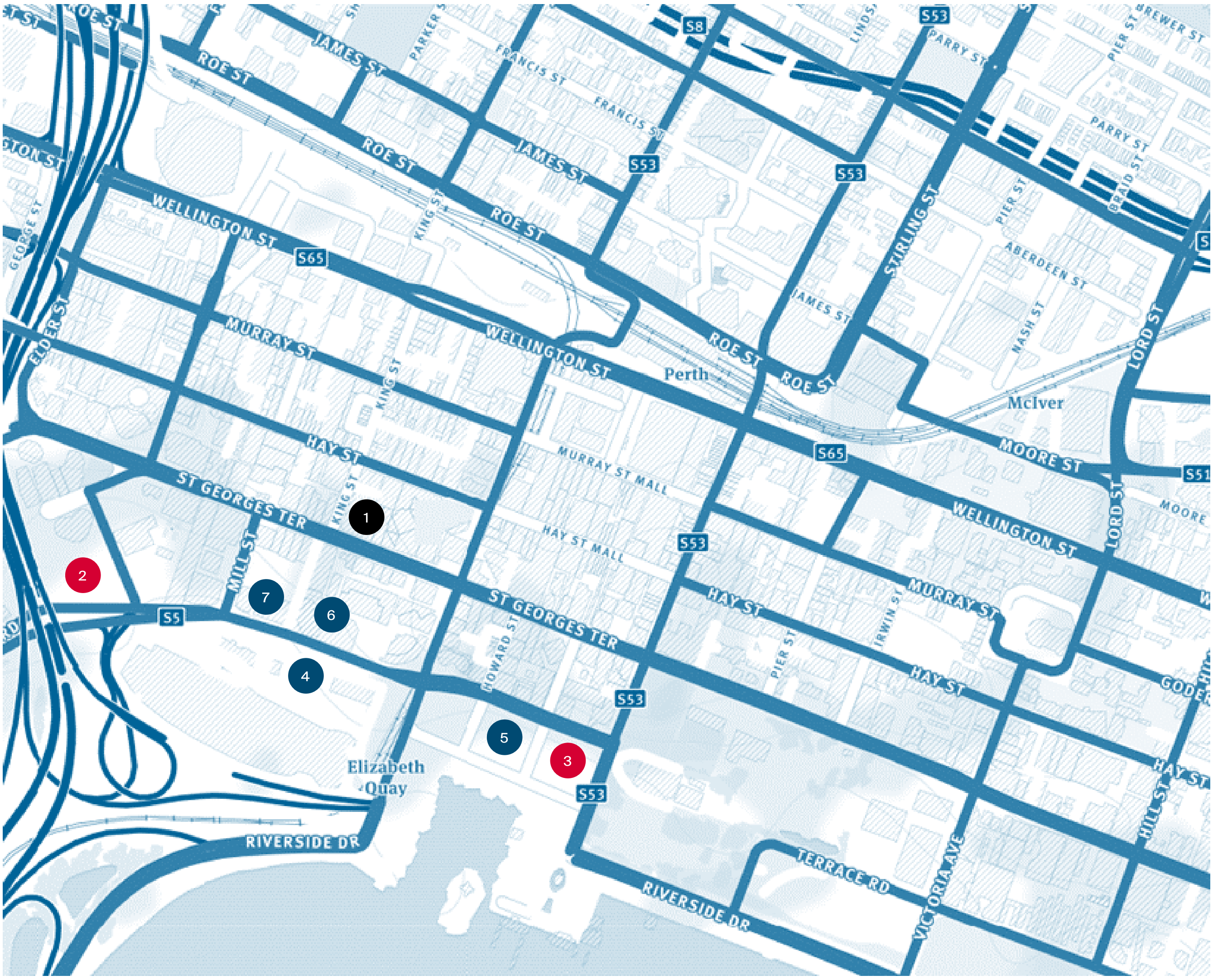
Source: Knight Frank Research, PCA

Vacancy rate
By grade, per cent



Source: Knight Frank Research, PCA

MAJOR OFFICE SUPPLY



MAJOR REFURBISHMENTS

1 168-170 ST GEORGE'S TERRACE – 12,500 SQM
DRADGIN PTY LTD. H2 2021

UNDER CONSTRUCTION/ MAJOR PRE-COMMITMENT

2 CAPITAL SQUARE TOWER 2 (98 MOUNTS BAY ROAD) – 25,200 SQM
[BDO AND WOODSIDE]
AAIG MALAYSIA. H2 2021

3 LOTS 7 & 8 ELIZABETH QUAY (ONE THE ESPLANADE) – 50,000 SQM [CHEVRON]

DEVELOPMENT APPROVED

4 PERTH CONVENTION CENTRE PRECINCT (21 MOUNTS BAY ROAD) – 20,000 SQM
BROOKFIELD. H2 2025

5 LOT 5 ELIZABETH QUAY – 30,000 SQM
BROOKFIELD. H1 2026

6 WESTRALIA SQUARE (141 ST GEORGES TERRACE) – 11,000 SQM
GDI. DATE TBC

7 1 MILL STREET– 34,000 SQM
GDI/LENDLEASE. DATE TBC

INCENTIVES RISE BUT PRIME FACE RENTS REMAIN RELATIVELY STABLE

Prime incentives rose sharply in 2020 but stabilised in the December quarter

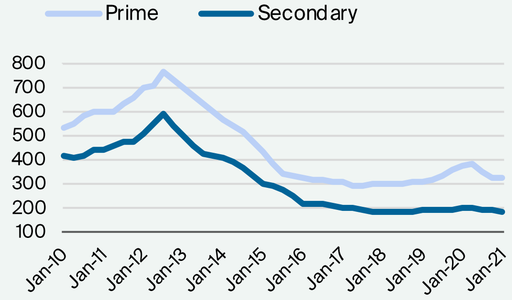
The pandemic has been characterised by a large increase in incentives and a sharp fall in effective rents. Average prime incentives rose by 4.2 percentage points over the three months to October 2020 to 48.3%, but remained unchanged over the three months to January 2021. Average prime incentives are 8.3 percentage points higher than a year ago, and currently range from around 46.5% to 50%. Prime net effective rents rose by 0.3 per cent over the three months to January to $319/sqm, but remain 7.9% lower over the half-year. Net effective rents declined by 14.1% over the year to January 2021 compared to the 20.8% growth recorded over the previous year.

Prime net face rents rose by 0.3 per cent over the three months to January to $617/sqm but remain 0.4 lower over the half-year. Over the year to January 2021, face rents fell by 0.3%, slowing from the 4.7% growth rate recorded over the year to January 2020.

In the secondary market, net effective rents fell by 4.1% in the three months to January to be 8.0% lower over the year. Average incentives rose from 52.5% to 53.1% over the three months and range between 50% and 56%. Net face rents declined by 2.8% over the three months to January and are 5.9% lower over the year.

The average rental discount between the prime and secondary market is 38% in face terms and 44% in effective terms, above the historical averages of 30% and 31% respectively.

Net effective rent
By grade, $/sqm



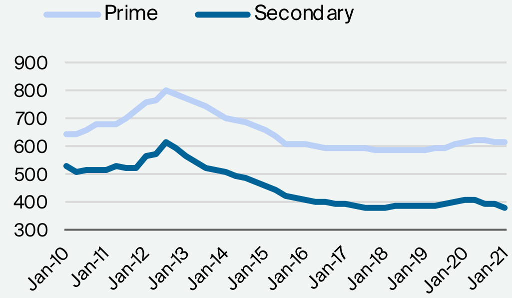
Source: Knight Frank Research

Rental growth likely to remain soft in 2021 before recovering over the next few years

Prime effective rents are likely to fall modestly in 2021 as average prime incentives peak at around 50% by mid this year. Incentives are then expected to begin to decline steadily from 2022 onwards, as momentum in the leasing market strengthens, leading to relatively rapid growth in effective rents compared to other major capital city markets in the mid-2020s.

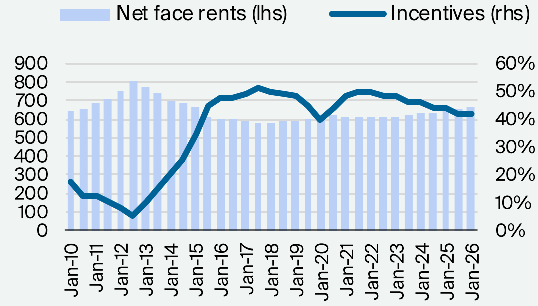
Prime face rents are expected to grow by between 2% and 3% per annum between 2023 and 2025 as net absorption strengthens and the vacancy rate declines.

Net face rent
By grade, $/sqm



Source: Knight Frank Research

Prime rents and incentives
Net, $/sqm (lhs), per cent (rhs)



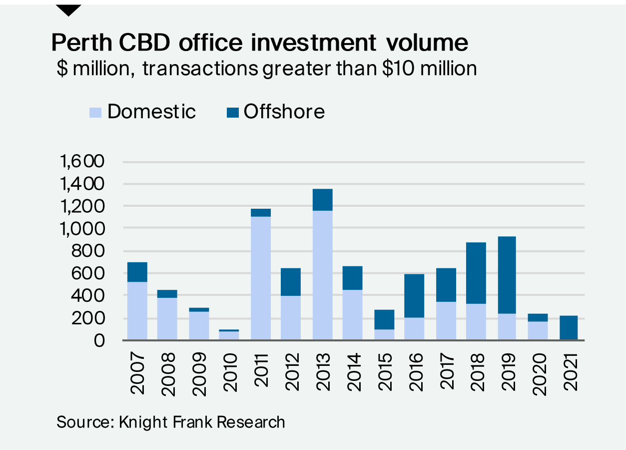
Source: Knight Frank Research

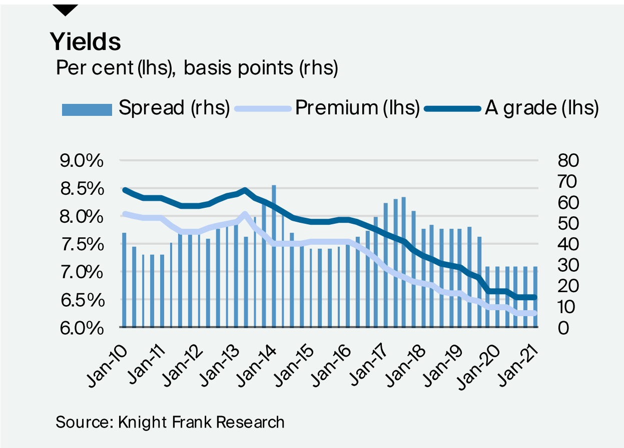
INVESTMENT ACTIVITY BEGINNING TO PICK UP

Investment volume in 2020 falls to lowest level in a decade but Q4 activity in line with 10-year average

Investment volume in the Perth CBD totalled $231.9 million in 2020, down 75% on the relatively high level recorded in 2019, and the lowest level since 2010. However, investment picked up in late 2020, with 65% of deals by volume occurring in the December quarter, reflecting growing confidence in the outlook for the Perth CBD. Among the largest deals in Q4 were Fiveight's (a subsidiary of Andrew Forrest's Tattarang) purchase of 190 St Georges Terrace from Credit Suisse for $55 million and Redhill Partners' acquisition of 905 Hay Street from the Stamford Land Corporation for $67.8 million.

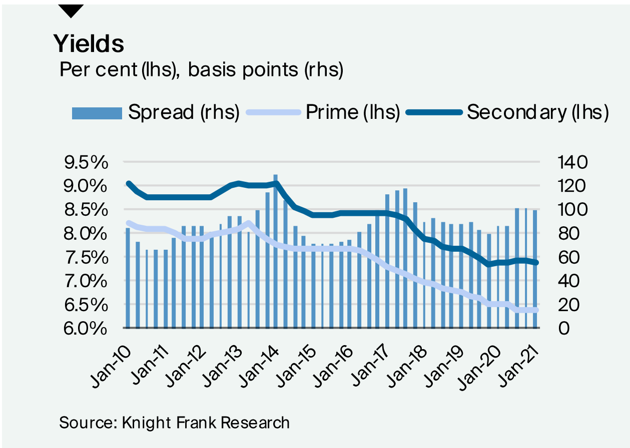
Transaction activity received a further boost in February, with GIC reaching an agreement to purchase a 25% stake in One The Esplanade from Brookfield for $220 million, the first major transaction of 2021. This positive momentum has continued with the settlement of 16 Victoria Avenue and AMP taking 140 St Georges Terrace to market with further large scale assets set to come to market later this year.





Prime yields hold firm reflecting long-term investor confidence in Perth

Yields on prime office assets have remained stable over the past six months at 6.40%, and are 12.5 basis points lower than a year ago. The spread between premium and A grade yields remains unchanged at 29.2 basis points. Secondary yields tightened by two basis points to 7.40% over the same period (but remain marginally higher over the year) leaving the spread to the prime yield 2.1 basis points lower compared to six months ago at 100 basis points, compared with a 10-year average of 90.3 basis points.



We like questions, if you've got one about our research, or would like some property advice, we would love to hear from you.

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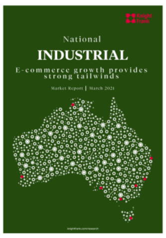
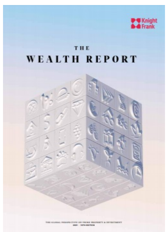


National Industrial Market Report March 2021



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