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HIGHLIGHTS

- Following the completion of Eclipse Tower adding 25,080m^2 of office NLA to the Parramatta market, the vacancy rate recorded an increase to 9.7% as at January (vs 8.8% July 2012). However with the gap between economic rents and markets rents remaining a challenge for developers, potential projects remain mooted such that it is unlikely that any major new supply will be added until 2016. This is set to continue the relatively tight vacancy in the prime market, which accounts for only 15% of market vacancies. Notwithstanding a short term fluctuation due to backfill refurbishment and re-entry, the total vacancy rate is forecast to gradually decline to circa 9.0% over 2013 before declining to sub 8% during 2014.
- Low prime vacancies, particularly for larger, full floor options has underpinned strong rental growth over the past two years, during which time prime gross face rents have increased 11.1% to now average \$487/m^2. However, the last six months has seen tenants exercising constraint in their decision making, which has seen some moderation in the rate of rental growth. At the same time average prime incentives for full floor leases have moved out to 20% and are expected to remain elevated in 2013 before reducing in 2014 as demand normalises in a supply constrained market.
- A much more active investment market has seen sharp pick-up in the number of completed deals with 2012 calendar year sales (\$10 million+) totalling \$301.7 million. Although prime core market yields based on a five year WALE are estimated to range from 9.00% to 9.75%, modern buildings with longer lease expiries ("upper prime") are being priced at a significant premium to this range, with Eclipse Tower for example transacting at a 7.35% yield.

PARRAMATTA OFFICE OVERVIEW

Table 1
Parramatta Office Market Indicators as at April 2013

Grade	Total Stock (m^2)^	Vacancy Rate (%)^	Annual Net Absorption (m^2)^	Annual Net Additions (m^2)^	Avg Gross Face Rent ($/$m^2$)	Outgoings ($/$m^2$)	Average Incentive (%)	Average Core Market Yield (%)
Prime	255,017	4.1	19,526	25,050	440 - 540 (487 Avg)	109	17.5 – 22.5	9.00 - 9.75*
Secondary	447,704	12.9	-6,808	-7,018	345 - 425 (395 Avg)	101	22.5 - 27.5	10.00 - 11.00
Total Market	**702,721**	**9.7**	**12,718**	**18,032**				

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

Grade: Prime includes modern and A-grade stock whilst secondary includes B, C and D quality grade.

Source: Knight Frank/PCA ^ as at Jan 2013 *upper prime assets with long WALEs trading below this range (sub 8%)

Development Activity

The completion of 'Eclipse' at 60 Station Street marked the first major supply addition in Parramatta since Sydney Water HQ in 2009. However the market is again facing several years without any major new development completions with potential supply projects either awaiting pre-commitments or still in the planning stage. Of the DA Approved projects, stage one of 142 Macquarie St (11,980m²) by News Limited is for owner occupation and will directly add to net absorption given it will represent the consolidation of a number of business locations all external to Parramatta. The other DA approved projects, 89 George Street and 105 Phillip Street, however will require pre-commitment. While several tenant enquiries have been circulated into the market for large A-grade leasing options, economic rents close to $80/m² in excess of average market rents remain a challenge for developers to meet these briefs.

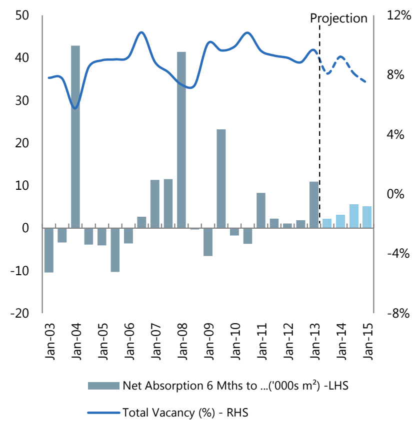
Other major potential projects include Council's 169 Macquarie Street site (part of Parramatta Square), stage two of the Cumberland Media Centre (35,000m²) and additions to the Westfield Centre (30,000m²). Two refurbished backfill options stemming from Eclipse will also be added to the market in 2013. These consist of 56 Station St (ex QBE) and 1-3 Fitzwilliam St (ex State Property Authority, who have also leased space at 10 Smith Street), which will provide the market with its largest, available whole floor building with floor plates of 600m².

Table 2
Office Supply Major potential Parramatta developments

Address	Area (m^2)	Developer/ Owner	Stage	Est. Date of Compl.
Eclipse, 60 Station St	25,728	REST*	Complete	Q3 2012
56 Station St#	4,800	Yangdo Pty Ltd	U/C	Q2 2013
1-3 Fitzwilliam St#	9,700	Private	U/C	Q3 2013
142 Macquarie St – Stage 1	11,980	News Ltd	DA Approved	2015+
89 George St	11,567	Webb Property	DA Approved	2015+
105 Phillip St	20,000	DEXUS	DA Approved	2016+
169 Macquarie St	24,200	Council^	DA Submitted	2016+
142 Macquarie St – Stage 2	35,000	News Corp	Early Planning	2016+
Westfield, 159 Church St	30,000	Westfield	Early Planning	2016+
Greenway Arc, 48 Macq. St	20,000	Drivas/Telado	Early Planning	2016+
2 Fitzwilliam St	16,260	Transport For NSW	Deferred	2016+

Source: Cordell Connect/Knight Frank Estimates # refurbishment U/C refers under construction
*purchased from developers Grosvenor and Leighton Properties Nov 2012 ^ Parramatta City Council

Figure 1
Vacancy and Net absorption
Parramatta – per six month period (000's m²)



Source: PCA/Knight Frank

Vacancy & Tenant Demand

As a result of some residual vacant space in Eclipse at the beginning of the year, the Parramatta market recorded an increase in the vacancy rate to 9.7% as at January compared with 8.8% in mid 2012. This also saw the A-grade vacancy rate rise from 2.2% to 4.1%, a level above the five year average of 2.6%. However with this residual space subsequently leased and resulting backfill space undergoing refurbishment, the prime vacancy rate is estimated to again be sub 3%.

Although the net absorption figure of 10,888m² in the six months to January was the strongest outcome since 2009, this was largely a result of tenant moves into Eclipse from leasing deals struck more than a year ago. However, recent leasing activity indicates underlying demand has moderated compared to the first half of 2012 and is softer than the headline absorption figure suggests.

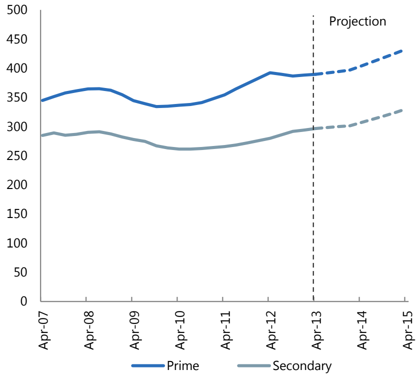
This is being borne out in reduced urgency from tenants, which is constraining the rate at which enquiries have translated into deals. While this has partly been attributable to a lack of confidence, tenant movement has also been limited by landlords increasing renewal incentive levels close to, or equivalent to, incentive levels for new leases. This is most notable for sub 500m² tenants. For larger tenants however, a lack of large, alternative options remains a constraint to moving. Tenants are also displaying a preference for fitted out space in order to take lease incentives in the form of rental abatement, which they can use to fund a move into a higher quality fitted out space.

Leasing Market and Rents

Low prime vacancies, particularly for larger, full floor options has underpinned strong rental growth over the past two years, during which time prime gross face rents have increased 11.1% to now average $487/m² ($378/m² net) . However the last six months has seen the rate of face growth ease, while at the same time prime incentives for full floor leases have moved out to an average of 20%. This has resulted in a moderation in effective rents (refer Figure 2). For smaller tenancies, incentives on new leases can be between 20% and 25% given the high number of competing options.

With tenants exercising constraint when making premises decisions, prime face rental growth is forecast to average CPI over 2013 with incentives holding steady. In 2014, an anticipated improvement in demand coupled with the lack of new supply is forecast to drive slightly stronger rental growth in addition to some downward pressure on incentive levels.

Figure 2
Parramatta Rents
$/m² average gross effective rent



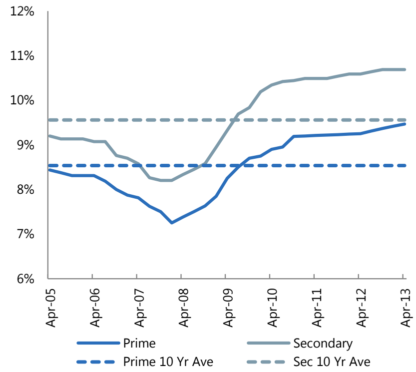
Source: Knight Frank

Sales & Investment Activity

Sales activity picked up substantially in 2012, particularly towards the end of the year and resulted in calendar year sales ($10 million+) totalling $301.7 million. This total was more than the previous four years combined and was significantly boosted by the sale of Eclipse to superannuation fund REST for $167.5 million. Other major sales (refer Table 4) were made up of lower A-grade assets, with buyer types split between wholesale funds and private buyers.

Average core market yields range between 9.0% and 9.75% for prime and 10.0% and 11.0% for secondary. While the prime range is higher compared to a year ago, it is largely a reflection of transaction evidence providing clarity to the market and indicates the large gap that had existed between buyer and vendor expectations. It is also noted that these yield ranges are based on a basket of assets with an assumed WALE of five years. However, new buildings with long WALEs are being priced at a significant premium to the market and will trade well below this range as shown with the Eclipse sale, which traded on a core yield of 7.35%.

Figure 3
Average Core Market Yields
Parramatta



Source: Knight Frank

Table 3
Recent Leasing Activity Parramatta

Address	Face Rental ($/m²)	Area (m²)	Term (yrs)	Lease Type	Tenant	Start Date
88 Phillip St	310n	600	5	New	Randstad	Feb-13
460 Church St	350g	930	6	New	Revolution I.T.	Dec-12
110 George St	360n	693	5	New	Michael Page	Dec-12
81 George St	280g	1,300	5	New	SSI	Nov-12
80 George St	310n	255	5	New	Indesco	Oct-12
9 George St	360n	850	5	New	Tyco	Aug-12

Table 4
Recent Sales Activity Parramatta

Address	Price ($ mil)	Core Market Yield (%)	NLA (m²)	$/m² NLA	WALE (Years)	Vendor	Purchaser	Sale Date
18 Smith St	47.50	10.20	12,041	3,963	3.2	Capital Corporation	Altis Property Grp	Dec-12
75 George St	32.55	10.14	9,535	3,414	3.8	Stockland	Corval	Dec-12
60 Station St	167.50	7.35	25,728	6,510	8.6	Grosvenor & Leighton Prop.	REST	Nov-12
132 Marsden St	25.53	10.10	9,789	2,607	3.2	Centuria	Sandran P/L	Aug-12
16-18 Wentworth St	18.00	9.50*	6,673	2,698	1.9	LaSalle Aust Core Plus Fund	Private Investor	Apr-12

Source: Knight Frank g gross n net * accounts for potential expiry of major tenant (46% NLA) in 2014 and therefore risk adjusted to some extent

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Indonesia
Macau
Malaysia
Singapore
South Korea
Thailand
Vietnam

The Gulf
Bahrain
Abu Dhabi, UAE

Knight Frank Newmark Global

Knight Frank Research
Nick Hoskins
Associate Director – NSW Research
+61 2 9036 6766
Nick.hoskins@au.knightfrank.com

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

Knight Frank Valuations
David Castles
State Director, Knight Frank Valuations
+61 2 9036 6648
David.castles@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

Commercial Agency - Leasing
John Siciliano
Director – Office Leasing, Parramatta
+61 2 9761 1833
John.siciliano@au.knightfrank.com

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

Commercial Agency - Sales
Derek Erwin
Managing Director, West Sydney
+61 2 9791 1836
Derek.erwin@au.knightfrank.com

James Parry
Managing Director
Capital Markets Australia
+61 2 9036 6758
James.parry@au.knightfrank.com

Richard Horne
Managing Director, NSW
+61 2 9036 6622
Richard.horne@au.knightfrank.com

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