

PARRAMATTA

OFFICE MARKET BRIEF NOVEMBER 2015

Key Facts

Total vacancy measures 7.4%, while prime vacancy remains much tighter at 2.4%, the lowest prime vacancy rate across Sydney.

Construction of Parramatta Square is underway and marks the beginning of a new round of commercial projects and supply.

Since October 2014, prime annual face rental growth has measured 3.8%, while growth was stronger in secondary at 5.3%.

Prime yields have firmed 109 bps since October 2014, while secondary yields have firmed 142 bps.



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Investor activity in 2015 remains strong in Parramatta, however is concentrated in the \$25 – \$45 million range given the largest buildings have mostly traded in the preceding two years. Despite some space consolidation by NSW Police, the prime market remains very tight with a vacancy rate of 2.4%.

Development Activity

Recent development activity within Parramatta has been limited to refurbishments. In 2015 this included the refurbished backfill space at 1-3 Fitzwilliam Street (9,785m²), where Raffles Education occupies two thirds of the building (as owner occupier). However, aside from this refurbished space, no new developments have reached completion since Eclipse in 2012. The hiatus in new supply will be short lived with the Parramatta market having entered the early phase of a commercial development upswing. This supply is largely underpinned by Parramatta Square, where the first stage of the development, known as 1PSQ (located at 169 Macquarie Street), is already under construction having achieved a 26,000m² pre-commitment from the University of Western Sydney (UWS), who will occupy the whole building. 1PSQ is owned by two of Charter Hall's managed funds and is being developed by Leighton Properties and constructed by John Holland.

Parramatta City Council has appointed Walker Corporation as the developer for the two largest stages of the Parramatta Square development. One of these stages is known as Stage 2 and comprises the Aspire residential tower. The other is known collectively as Stages 5 and 6, which comprise the largest commercial component of the redevelopment precinct and will provide up to 126,000m² commercial space across two interconnected towers in addition to a podium retail component. As yet, no pre-commitments have been formalised.

With Alfasi's development rights over Stage 3 having expired, Parramatta City Council is yet to appoint a new developer for the 24,000m² Stage 3. Nevertheless, the council remains committed to progressing the stage in the short term. A number of other projects have potential to add to supply in the medium term with the pipeline comprising the DA approved projects of 89 George Street (11,567m²) and 105 Phillip Street (20,000m²).

There is a substantial amount of residential development activity currently underway in Parramatta, with approximately 7,000 apartments due to complete within the next five years. Helping to facilitate these developments has been a number of older secondary office buildings withdrawn for residential or mixed use purposes. Change of use withdrawals have totalled 12,150m² (1.8% of current office stock) over the past two years in order to supplement the strong population growth in Western Sydney. Knight Frank is currently tracking 38,624m² (5.6% of stock) of office space across 11 assets that have the potential to be redeveloped into 2,520 residential apartments.

Net Absorption & Vacancy

In the first half of 2015, vacancy rates increased by 110 bps to measure 7.4% as at July (vs 6.3% as at January). Split by grade, vacancy rates have increased by 160 bps to 2.4% for prime and 60 bps

to 10.6% for secondary since January. Despite the rise, the prime vacancy rate remains trending below the 10 year average of 3.3%. Parramatta's prime vacancy rate is also the lowest of suburban markets in Sydney—with North Ryde and North Sydney following closely behind at 3.6% and 3.7% respectively.

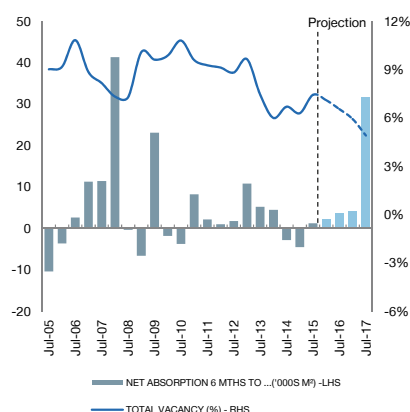
Given the lack of quality leasing options in the market, the change in occupied stock levels have been relatively minor over the past 18 months. While some tenant displacements stemming from change of use withdrawals resulted in modest negative net absorption in 2014, the result has turned positive in 2015. Adding to positive demand was the occupation of Raffles Education into 1-3 Fitzwilliam St in the first half of 2015. However, this was offset by some consolidation of total space occupied by NSW Police, who handed back 4,335m² to the market. There is also evidence of demand benefitting from suburban residential conversions, with a number of displaced tenants relocating to the Parramatta market, including College of

Nursing who moved from Burwood. With 1PSQ fully preleased, the vacancy rate is expected to remain tight over the next two years. There is potential for some upward pressure on vacancies in the medium term, should more of the development pipeline be progressed to the construction stage. Although it has been announced that the Commonwealth Bank of Australia (CBA) will consolidate their suburban tenancies into newly developed space at the Australian Technology Park (ATP) in Redfern, this departure will not occur until 2020. As such, any impact on the vacancy rate will not occur in the short term. Nevertheless, the 39,891m² of backfill space (5.8% of total office stock) which they currently occupy will need to be digested in the medium term.

Rents

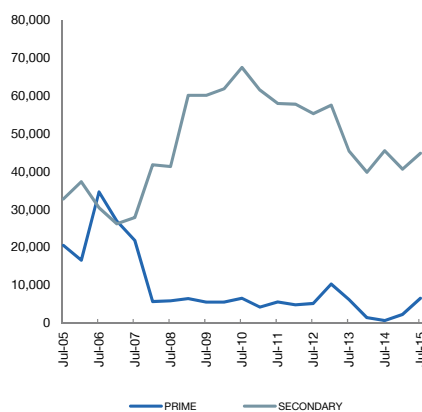
Due to the relative tightness of the market, rental growth remains positive in both the prime and secondary market. Average prime net face rents currently measure \$426/m² (\$537/m² gross),

FIGURE 1
Net Absorption and Vacancy
Per six month period (000's, %)



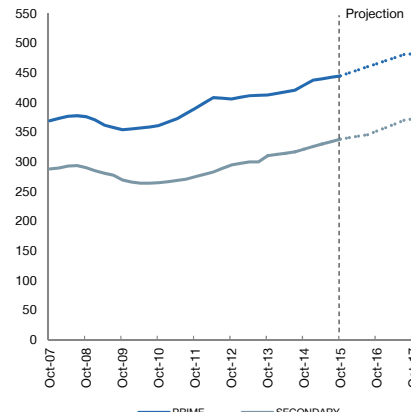
Source: Knight Frank Research/PCA

FIGURE 2
Parramatta Vacancy
Total vacancy by grade (m²)



Source: Knight Frank Research/PCA

FIGURE 3
Average Gross Effective Rent
Parramatta (\$/m²)



Source: Knight Frank Research

TABLE 1
Parramatta Office Market Indicators as at October 2015

Grade	Total Stock (m ²) [^]	Vacancy Rate (%) [^]	Annual Net Absorption (m ²) [^]	Annual Net Additions (m ²) [^]	Average Gross Face Rent (\$/m ²)	Outgoings (\$/m ²)	Average Incentive (%)	Average Core Market Yield (%)
Prime	273,617	2.4	-5,898	0	537	111	21.6 (net)	7.25 - 7.75*
Secondary	416,456	10.6	2,731	2,045	451	110	25.0 (gross)	8.00 - 8.75
Total	690,073	7.4	-3,167	2,045				

Source: Knight Frank Research/PCA

[^] Data as at July 2015

* Upper prime assets with long WALEs are trading below this range (sub 7.0%)

reflecting strong annual growth of 3.8%. This growth has predominantly come in the form of lease renewals. Prime net incentives have held broadly steady and range between 20% and 25%. While this level is higher than would ordinarily be expected for a market with a sub 3% vacancy rate, relatively high incentives have been a result of competition from other suburban markets where incentives are higher.

With the prime vacancy rate expected to remain relatively tight over the next two years, there is scope for the recent momentum in rental growth to be sustained over FY16 and FY17. Prime face rental growth is expected to be slightly in excess of CPI during these two years, with average growth of 3% per annum forecast. While a modest fall in incentives to 19% by the end of FY17 is also expected, the degree of any reduction will partially be offset by relatively high incentives in competing suburban markets, as well as pre-lease competition as developers look to progress the market's supply pipeline.

With the limited availability of prime grade office stock in Parramatta, tenants have looked to secondary grade stock to satisfy their tenancy needs. Demand has been most prevalent in lower A-grade and upper B-grade facilities which have undertaken refurbishment. As a result of this demand flowing into secondary assets, rents have grown significantly over the past 12 months. Secondary net face rents currently average \$341/m² (\$451/m² gross) - a strong annual increase of 5.3%. Secondary incentives remained stable at 25% gross - unchanged since 2011.

TABLE 2

Recent Leasing Activity Parramatta

Address	NLA (m ²)	Face Rental (\$/m ²)	Term yrs	Lease Type	Tenant	Date
One Parramatta Sq.	26,000	Conf	Conf	Pre-com	UWS	H2 2016
10 Smith St	1,775	402n	3	Option	Matthew Folbigg	Feb-16
2 Macquarie St	1,831	410n	5	New	Hanson Constr.	Sep-15
20 Smith St	897	395n	5	New	Injury Treatment	Sep-15
126 Church St	5,700	375n	3	New	PCC	Aug-15
9 Wentworth St	1,222	360n	5	New	Aust. College of	Jun-15

Source: Knight Frank Research n refers net

Investment Activity & Yields

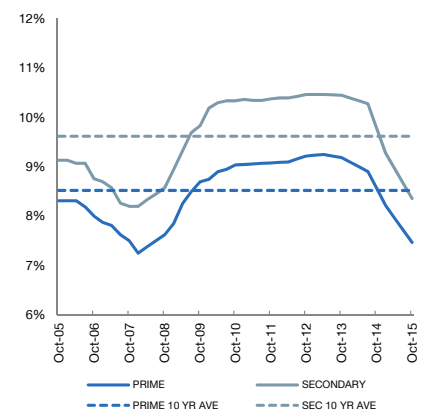
There exists a heightened amount of capital seeking investment opportunities within the Parramatta market. Investment sales over the past 12 months (to November) amount to \$572.4 million across 14 commercial properties (excluding 1PSQ). The bulk of major prime Parramatta assets have been sold over 2013 and 2014, including the Justice Precinct, Sydney Water, Eclipse and NSW Police. The 2015 buying activity has been concentrated on sub \$50 million assets in the market—purchased primarily by local buyers—unlisted funds, syndicates and private investors—accounting for 86% of major transactions (over \$5 million) in the 12 months to November.

Prime and secondary yields across the broader Parramatta market have compressed 109 bps and 142 bps respectively since October 2014, to stand at a range of 7.25% to 7.75% and 8.00%

to 8.75% respectively (assuming a 5 year WALE). Substantial downward pressure has tightened yields every quarter since their peak in April 2013 (see Figure 4), however yields have not reached the

FIGURE 4

Average Core Market Yields Parramatta (%)



Source: Knight Frank Research

TABLE 3

Recent Sales Activity Parramatta

Address	Price (\$ mil)	Core Mkt Yield (%)	NLA (m ²)	\$/m ² NLA	WALE (yrs)	Vendor	Purchaser	Sale Date
93 George St	37.3	8.50	7,127	5,234	2.9	Marprop	Hannan	Oct-15
17-21 Macquarie St	18.8	8.10	4,718	3,975	2.1	Caleven Property	Lederer Group	Sep-15
20 Charles St	31.0	7.90	6,364	4,871	2.9	Global Three	Hannan	Jul-15
9 George St	30.0	7.50	5,414	5,541	2.4	Hyperion Property Syn.	Hadley Green Investment Group	Jun-15
91 Philip St	30.0	8.00	5,704	5,259	3.3	Fortius	Capital Property Funds	Jun-15
80 George St	38.7	8.00	8,184	4,729	3.1	Heathley Asset Mgmt	GDI Property Group	Apr-15
3 Horwood Pl	25.4	8.00	5,013	5,067	2.1	MAB Diversified Trust	IOOF	Jan-15

Source: Knight Frank Research

nadir experienced in January 2008, at the onset of the global financial crisis. The Parramatta prime and secondary markets are now trading at yields 100 bps and 121 bps below the 10 year average respectively, as at October 2015. While partly a result of increased capital being allocated to property, firming has also reflected a rerating of the Parramatta market, as it has looked to position itself as Sydney's second CBD.

The most recent November transaction of 93 George St was purchased for \$37.3 million by the Hannan family. The fully leased property, leased 80% by Government Property NSW, was previously purchased by Marprop in late 2013 for \$28.8 million – highlighting almost 30% capital value growth over two years of holding.

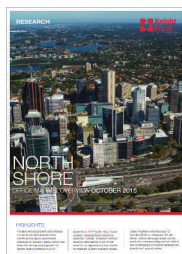
In spite of the high level of investment demand, transactions are likely to drop in the short term due to the high level of recent activity limiting the remaining stock available to trade.

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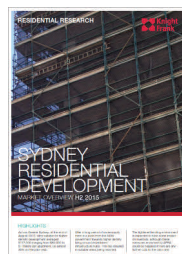
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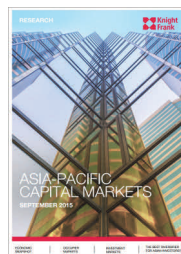
Sydney CBD Office
Market Overview
September 2015



North Shore Office
Market Overview
October 2015



Sydney Residential
Development
H2 2015



Asia Pacific Capital
Markets Report
September 2015

Outlook

Recently released job creation figures shows New South Wales as having provided 50% of the nation's new jobs. Coupled with strong population growth for Western Sydney, Parramatta holds a positive outlook for the leasing market over the next two years.

The Parramatta market is expected to undergo significant supply rejuvenation over the next five years, as substantial developments come to fruition including individual stages of Parramatta Square and the residential Aspire tower. These projects are a much needed response to the tight prime vacancy.

These factors are expected to see a continuation of strong investor demand in the market, particularly given the strong appetite for commercial property, providing higher comparable yields against the historically low government bond rates. Although a firming bias on yields still exists in the market, further cap rate compression is expected to be more modest, particularly if long term interest rates rise.

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VALUATIONS

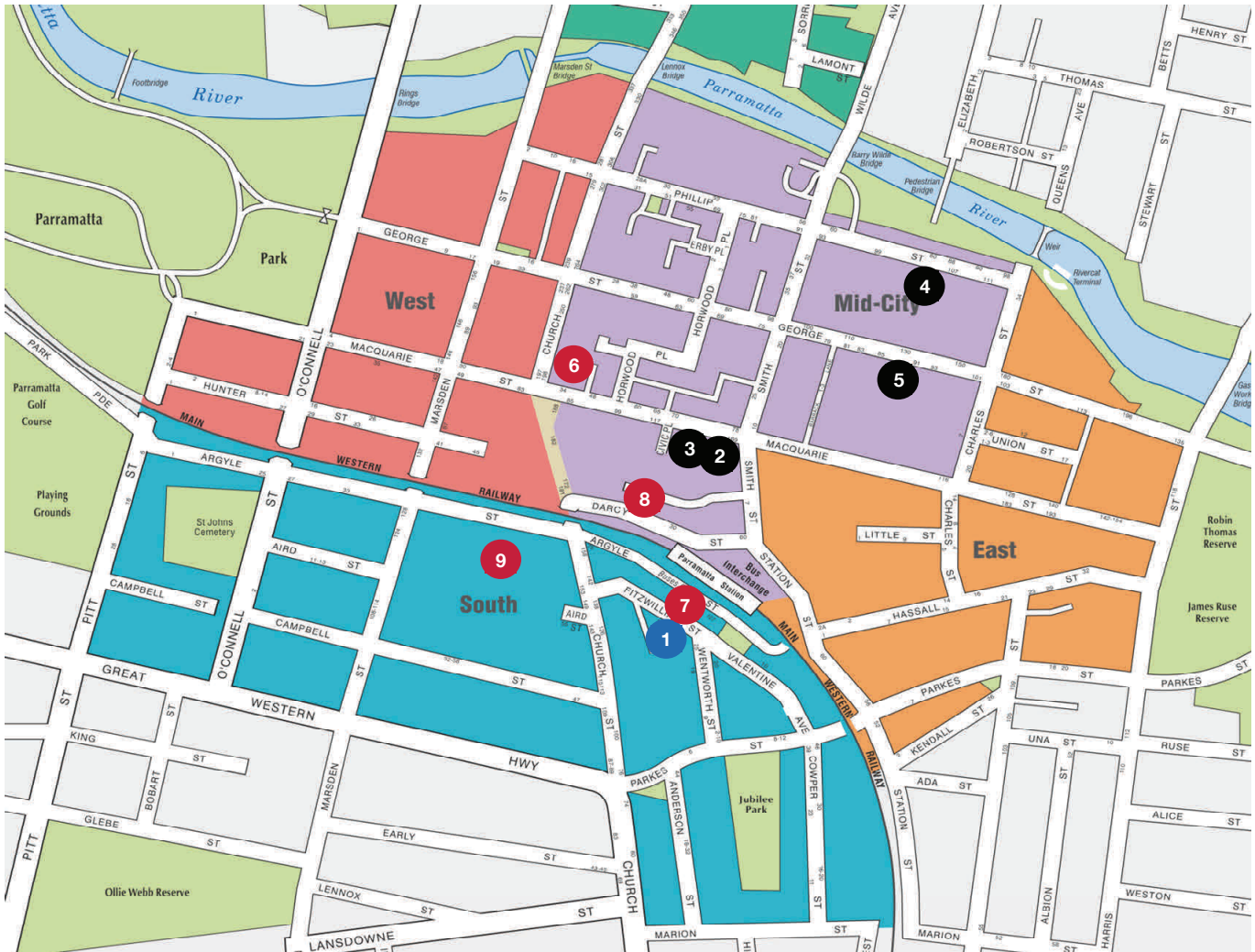
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MAJOR OFFICE SUPPLY



Source of Map: Knight Frank

- | | |
|--|--|
| <p>1 1-3 Fitzwilliam St[#] - 9,785m² [Raffles as owner occupier]
ICUC Holdings - Q2 2015 - 66% committed</p> <p>2 1PSQ, 169 Macquarie St[^] - 26,000m² [UWS]
Leightons/Charter Hall - early 2017 - 100% committed</p> <p>3 153 Macquarie St[^] - 24,000m²
Parramatta City Council - 2017+</p> <p>4 105 Phillip St - 20,000m²
DEXUS - 2018+</p> <p>5 89 George St - 11,567m²
Webb Property - 2018+</p> <p>6 Greenway Arc, 48 Macquarie St - 27,500m²
Drivas/Telado - 2018+</p> <p>7 2 Fitzwilliam St - 16,260m²
Transport for NSW - 2018+</p> <p>8 Parramatta Sq. Stages 5 & 6[^] - 126,000m²
Parramatta City Council (Walker) - 2018+</p> <p>9 Westfield, 159 Church St - 34,000m²
Westfield - 2018+</p> | <p>Under Construction/Complete</p> <p>DA Approved / Confirmed / Site Works</p> <p>Mooted / Early Feasibility</p> <p>NB. Dates are Knight Frank Research estimates
Includes select major office supply (NLA quoted)
Major tenant precommitment in [brackets] next to NLA
Major refurbishment
^ Part of Parramatta Square project</p> |
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