

# PARRAMATTA

## OFFICE MARKET BRIEF SEPTEMBER 2014

### Key Facts

**The A-grade market remains effectively full with a 0.2% vacancy rate**, while the 6.7% total vacancy rate makes Parramatta one of the tightest markets in the country.

**Construction of Parramatta Square is set to imminently commence** and marks the start of an expected upswing in new commercial supply.

**In the 12 months to July, prime face rental growth measured 3.1%**, however growth was a more modest 2.1% on an effective basis.

**Prime yields firmed 25bps over the past 12 months**, with further compression anticipated.



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Director - NSW Research

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A lack of available prime leasing stock and subdued demand has limited net absorption, however a large pipeline of potential projects provides a number of options for bigger space users. Investment demand remains firm with both offshore groups as well as local funds and syndicates active in the market.

### Development Activity

Led by the progression of Parramatta Square, the Parramatta office market is poised for a material upswing in new supply over the next five years. The formal announcement of the University of Western Sydney (UWS) signing a heads of agreement with Leighton Properties to pre-lease 26,000m<sup>2</sup> at 169 Macquarie Street is set to provide the first stage of the development with completion due at the end of 2016. The project will be known as 1PSQ or One Parramatta Square. It is anticipated that the third stage, to be developed by Alfasi and measuring 24,000m<sup>2</sup>, will follow shortly after with market speculation of an imminent pre-commitment. (Note Stage Three to be the second office tower with Stage Two comprising 'Aspire', a 90 storey residential/hotel tower to be built simultaneously.)

The largest commercial component of the Parramatta Square redevelopment precinct, known as Stages 5 and 6, will provide up to 126,000m<sup>2</sup> commercial space across two interconnected towers in addition to a

podium retail component. Although Council is yet to announce a development partner for these stages and a tenant pre-commitment is yet to be achieved, there is firm commitment from the Council for the twin tower to progress, although completion would not be for another four or five years.

Beyond Parramatta Square, the market has a number of potential sources of supply, however progression remains pre-commitment dependent. DA approved projects include 89 George Street (11,567m<sup>2</sup>) and 105 Phillip Street (20,000m<sup>2</sup>), while five other projects in the early planning stage ranging in size from 18,000m<sup>2</sup> to 34,000m<sup>2</sup> also exist.

While large suburban tenant pre-commitments have been relatively sporadic over the past five years, a number of major enquiries for prime, non-CBD facilities have been circulated in 2014. The bulk of this enquiry has stemmed from the Finance and Education sectors as well as Government departments, where some proposed/

potential decentralisation away from the CBD has been mooted. Parramatta's access to staff as well as established transport facilities and amenities position provide the market with a viable option for some of this enquiry.

In the meantime supply is set to be made up of 9,700m<sup>2</sup> refurbished backfill at 1-3 Fitzwilliam St, from where the State Government vacated in order to move into both Eclipse and 10 Smith St. Two thirds of the building will be occupied by Raffles Education (as owner occupier), who will relocate from their current premises in North Sydney. The residual space remains uncommitted.

## Net Absorption & Vacancy

Despite the vacancy rate recording a small rise in the first half of 2014 to 6.7% (vs 6.0% as at January), the Parramatta market remains one of the tightest office

markets in the country. This is particularly the case for prime stock, with the July vacancy rate measuring only 0.2%, which is equivalent to 675m<sup>2</sup>. The Parramatta prime vacancy rate has averaged 2.3% since the start of 2008. A number of leasing options exist in B-grade stock, where the vacancy rate measures 9.5%, however the majority are sub 500m<sup>2</sup> with limited contiguous floor plate options.

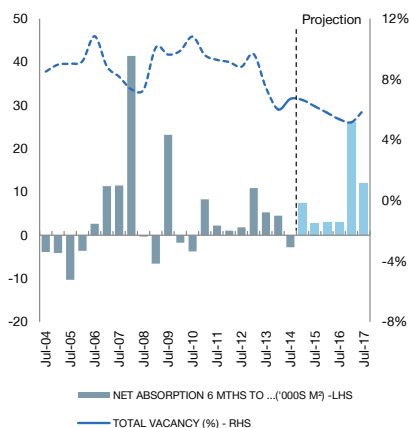
Tenant demand, as reflected by net absorption figures, has been relatively subdued over the past year. In the 12 months to July 2014, net absorption measured 1,737m<sup>2</sup> with the result impacted by absorption turning negative in the first half of 2014 to the tune of -2,737m<sup>2</sup>. This was the first negative six month period since 2010. Historically net absorption in Parramatta has been driven by the supply cycle and to this effect, the absence of recent supply completions (excluding Eclipse), the low vacancy rate and the lack of prime leasing options have partly contributed to a lack growth

in occupied space. Nevertheless, demand from existing tenants has remained soft and excluding the larger 10,000m<sup>2</sup>+ enquiry in the pre-lease market, leasing demand has stemmed from the smaller end of the market for sub-300m<sup>2</sup>, refurbished options. Over the past 12 months, deal flow from this part of the market has started to exhibit longer lease terms, a likely indicator of a mild recovery in tenant confidence. However, at this stage of the cycle, activity is yet to filter into the 500m<sup>2</sup>+ medium sized segment of the market.

## Rents

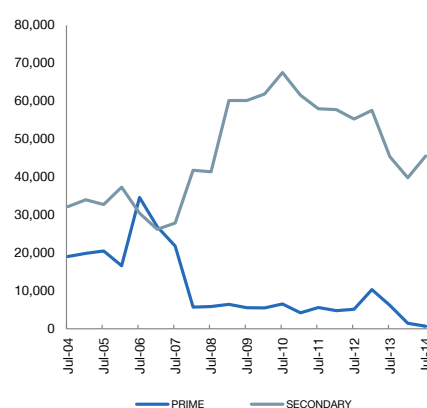
The substantially low A-grade vacancy rate has resulted in relatively firm prime rental growth in recent years. Average prime net face rents currently measure \$395/m<sup>2</sup> (\$507/m<sup>2</sup> gross), while pre-commitment net rents for new builds are in an approximate range of \$470/m<sup>2</sup> to \$495/m<sup>2</sup> in current prices (some potential net rents of up to \$525/m<sup>2</sup> have been

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



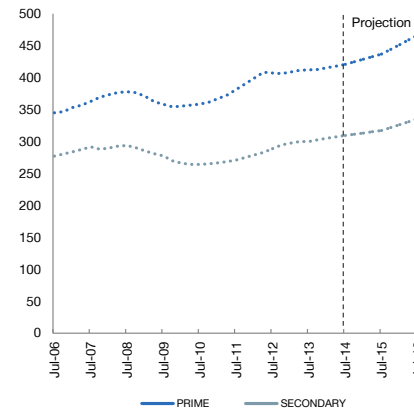
Source: Knight Frank/PCA

FIGURE 2  
**Parramatta Vacancy**  
Total vacancy by grade (m<sup>2</sup>)



Source: Knight Frank/PCA

FIGURE 3  
**Average Gross Effective Rent**  
Parramatta (\$/m<sup>2</sup>)



Source: Knight Frank

TABLE 1  
**Parramatta Office Market Indicators as at July 2014**

Grade	Total Stock (m <sup>2</sup> )	Vacancy Rate (%)	Annual Net Absorption (m <sup>2</sup> )	Annual Net Additions (m <sup>2</sup> )	Average Gross Face Rent (\$/m <sup>2</sup> )	Outgoings (\$/m <sup>2</sup> )	Average Incentive (%)	Average Core Market Yield (%)
Prime	273,617	0.2	582	0	507	112	22.0 (net)	8.00 - 9.25*
Secondary	591,087	11.0	1,155	-3,675	412	108	25.0 (gross)	9.50 - 10.75
<b>Total</b>	<b>688,028</b>	<b>6.7</b>	<b>1,737</b>	<b>-3,675</b>				

Source: Knight Frank/PCA

\* Upper prime assets with long WALEs trading below this range (to circa 7.0%)



mooted by market participants, although these are assumed starting rents for an on completion basis). These rents reflect 3.1% growth over the past year and average annual growth of 4.5% over the past three years. However prime incentives (net basis) have increased to an average of 21.9%, which has limited annual effective growth to 2.1% in the last year. The lack of available leasing options and the three year lag until the next supply cycle starts to come online is expected to sustain average annual face rental growth of 3.1% over the next three years. Incentives are anticipated to reduce moderately, however a reversal to more normal levels is being limited by elevated incentives in competing markets.

Despite higher vacancies in the secondary market, rental growth remains positive with secondary gross face rents increasing 3.2% over the past 12 months to \$412/m<sup>2</sup> (\$304/m<sup>2</sup> net) and gross incentives holding steady at 25%. Although growth reflects some tentative signs of improvement in demand from smaller tenants, growth has predominantly been driven by owners actively repositioning assets and capturing the associated uplift in rents, particularly given tenant preference for refurbished space.

## Investment Activity & Yields

In line with buying activity having become more firmly entrenched in non-CBD markets, investment sales over the past 12 months (to August) amount to a buoyant \$500.1 million. Boosting this

TABLE 2

### Recent Leasing Activity Parramatta

Address	NLA (m <sup>2</sup> )	Face Rental (\$/m <sup>2</sup> )	Term yrs	Lease Type	Tenant	Date
One Parramatta Sq.	26,000	Conf	Conf	Pre-com	UWS	H2 2016
91 Phillip St	940	Conf	Conf	New	KPMG	Sep-14
3 Horwood Pl	484	340n	5	New*	Clearview	Jun-14
91 Phillip St	432	340n	7	New	Knight Frank	Jun-14
35 Smith St	254	395g	5	New	Comm. Assoc.	Apr-14
25 George St	1,300	400g	5	New	Careers Aust.	Mar-14

Source: Knight Frank \* expansion space for existing tenant n refers net g refers gross

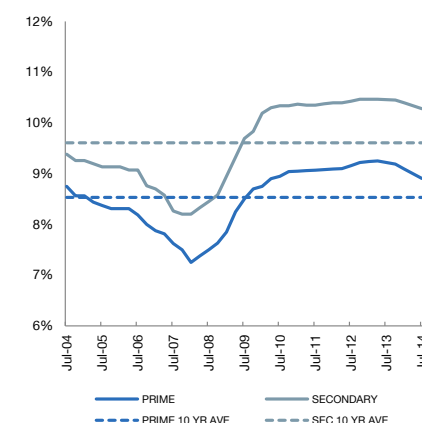
figure has been the strong market depth for large passive assets with long WALE from both offshore groups and well as local institutions. This has resulted in the sale of 1 Smith St (Sydney Water) in late 2013 to UK group Brompton Asset Management and more recently 1 Charles St (NSW Police), which sold to Growthpoint Properties Australia, with each asset reflecting circa 10 year WALEs (refer Table 3 for sale details). 1 Smith St traded on a core yield of 7.0%, while the core yield for NSW Police was relatively tighter at 6.6% (although it is noted that this reflected some assumptions about the perpetuity of a portion of special area rental, which when not accounted for reflects a yield closer to 7.0%). These sales continue to reflect the market premium for upper prime assets with 10+ year WALE. Such assets are further progressed through the yield firming cycle compared to the broader A-grade market as evidenced by the 7.35% yield reflected in the \$167.5 million sale of Eclipse in November 2012. The current offering by the NSW Government of the

19,875m<sup>2</sup> Parramatta Justice Precinct at 160 Marsden St with a 12 or 15 year leaseback, will provide further clarity for assets with this tenure.

FIGURE 4

### Average Core Market Yields

Parramatta (%)



Source: Knight Frank

TABLE 3

### Recent Sales Activity Parramatta

Address	Price (\$ mil)	Core Mkt Yield (%)	NLA (m <sup>2</sup> )	\$/m <sup>2</sup> NLA	WALE (yrs)	Vendor	Purchaser	Sale Date
1-3 Fitzwilliam St	29.00	N/A*	9,785	2,964	VP	ICUC Holdings	Raffles Education	Jul-14
1 Charles St	241.10	6.60^	31,954	7,545	9.9	AustralianSuper	Growthpoint Properties	Jun-14
1 Wentworth St	13.90	9.30	4,408	3,153	3.1	Rothby Holdings	Private Investor	Jun-14
88 Phillip St	20.25	9.70	5,260	3,850	2.6	CC Nominees	IOOF	Dec-13
1 Smith St	166.00	7.00	23,330	7,115	10.6	Brookfield Asset Mgmt	Brompton Asset Mgmt	Nov-13
93 George St	28.75	9.75	7,127	4,034	4.4	93 GSP Pty Ltd	Marprop	Nov-13
91 Phillip St	15.88	9.70	5,635	2,818	2.7	RBA Super. Fund	Fortius Funds Mgmt	Oct-13

Source: Knight Frank

\* purchased for part owner occupation

^ assuming income over special rental areas continues in perpetuity, core market yield reflects closer to 7.0%

Yield compression in the broader A-grade market, and as measured on the basis of a five year WALE, has been less pronounced with demand for sub-\$30 million assets being limited to mostly local syndicates. Average yields range between 8.0% and 9.25% for prime and 9.50% and 10.75% for secondary. Although this represents almost 25 bps of firming over the past 12 months, yields remain elevated above 10 year average levels (refer Figure 4). This relative discount is not evident in CBD and North Shore markets where yields have either converged or firmed below 10 year averages across most precincts and grades.

## Outlook

The Parramatta market appears well placed to undergo a period rejuvenation over the next five years. The progression of Parramatta Square in conjunction with the sharp upturn in residential development, which will provide around

7,000 new apartments to Parramatta over the next five years, are expected to boost local amenity and provide an attractive option for businesses looking at a non-CBD location.

However, with new supply not due to start entering the market until late 2016/early 2017, the prime market is expected to remain considerably tight. This is likely to result in a continuation of relatively firm rental growth, particularly from renewals given a lack of alternative options for sitting tenants.

There are a number of assets that have the potential to trade over the remainder of 2014 and, as a result, the strong levels of capital inflow and transaction activity are expected to be maintained. Given that firming of average yields in Parramatta has lagged other Sydney markets and that non-CBD investor interest has become more entrenched, it is anticipated that further compression is likely over the next 12 months as yield spreads between markets revert to more normalised levels.

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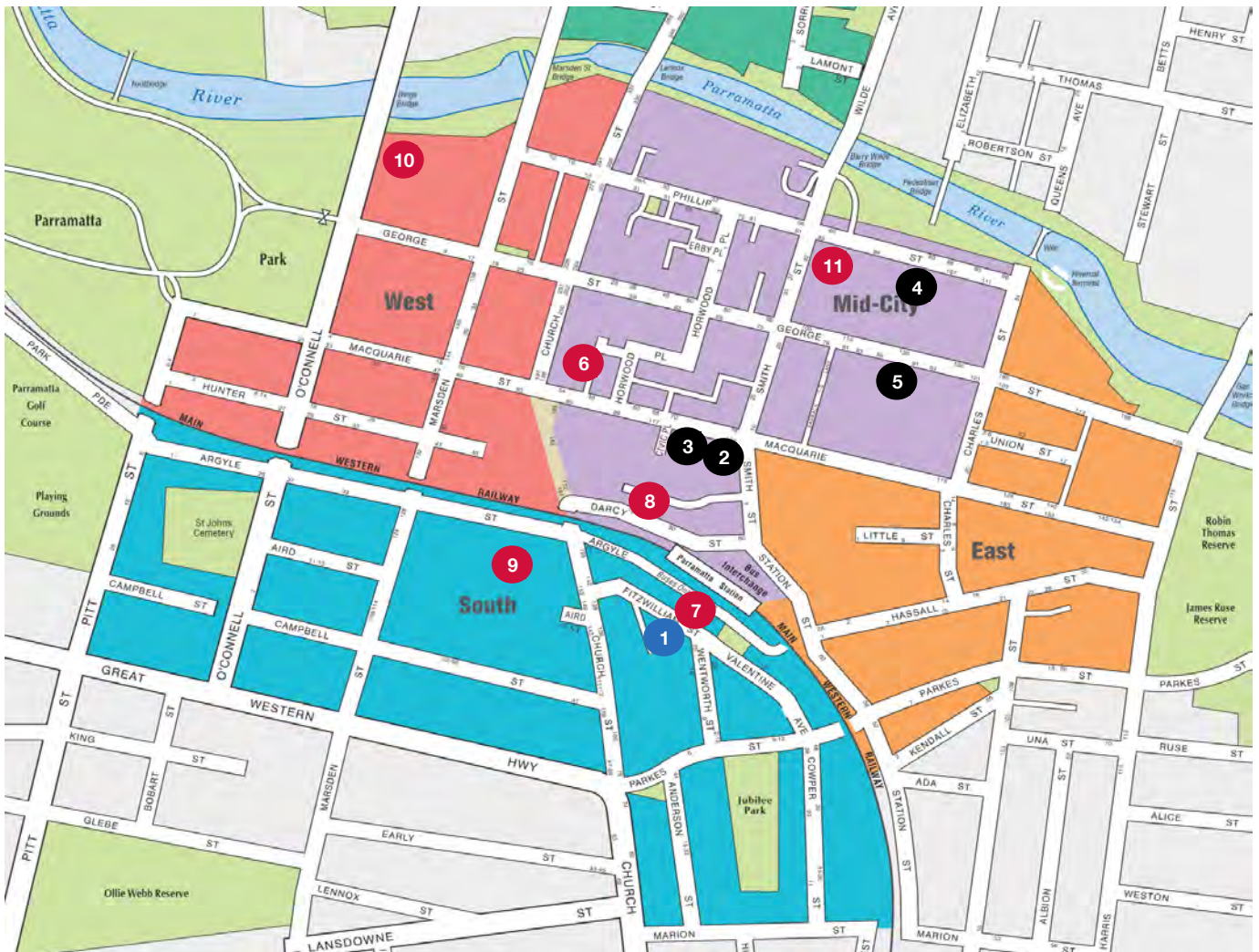
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# MAJOR OFFICE SUPPLY



Source of Map: Knight Frank

- 1** 1-3 Fitzwilliam St<sup>#</sup> - 9,700m<sup>2</sup> [Raffles as owner occupier]  
ICUC Holdings - Q3 2014 - 66% committed
- 2** 1PSQ, 169 Macquarie St<sup>^</sup> - 26,000m<sup>2</sup> [UWS]  
Leighton - end 2016 - 100% committed
- 3** 153 Macquarie St<sup>^</sup> - 24,000m<sup>2</sup>  
Alfasi - H1 2017
- 4** 105 Phillip St - 20,000m<sup>2</sup>  
DEXUS - 2017+
- 5** 89 George St - 11,567m<sup>2</sup>  
Webb Property - 2017+
- 6** Greenway Arc, 48 Macquarie St - 27,500m<sup>2</sup>  
Drivas/Telado - 2017+
- 7** 2 Fitzwilliam St - 16,260m<sup>2</sup>  
Transport for NSW - 2017+
- 8** Parramatta Sq. Stages 5 & 6<sup>^</sup> - 126,000m<sup>2</sup>  
Parramatta City Council - 2018+
- 9** Westfield, 159 Church St - 34,000m<sup>2</sup>  
Westfield - 2018+

- 10** 158 O'Connell St - 34,000m<sup>2</sup>  
Government Property NSW - 2018+
- 11** 30-32 Smith St - 20,000m<sup>2</sup>  
Salvation Army - 2018+

- Blue** Under Construction/Complete
- Black** DA Approved / Confirmed / Site Works
- Red** Mooted / Early Feasibility

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