RESEARCH

PARRAMATTA

OFFICE MARKET OVERVIEW MARCH 2015

HIGHLIGHTS

Stock withdrawals and no new supply has offset the –7,236m² in net absorption recorded over the past six months, reducing the vacancy rate to 6.3%.

The first stage of Parramatta Square has commenced construction and marks the beginning of Parramatta's next round of office projects.

Investment activity has been substantial in 2014 with sales totaling $666 million. Large $50 million + assets comprised 74% of this volume.

KEY FINDINGS

Withdrawals in other suburban markets over the next 2 years is likely to create an uplift in demand for office space at Parramatta.

The absence of new supply has resulted in a **prime vacancy rate of 0.8%.**

Tight vacancy rates and a lack of alternative relocation options continues to place **upward pressure on rents.**

Office sales during 2014 totalled $666 million, which is 2.8 times larger than the average recorded over the past five years.

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SUPPLY & DEVELOPMENT

A material upswing in supply is anticipated over the next five years. The first stage of Parramatta Square is due for completion in early 2017 and will signify the beginning of Parramatta's next round of projects.

Office construction in Parramatta has remained weak since the 2012 completion of 'Eclipse' at 60 Station Street with the only additions to supply since stemming from refurbishments. At the same time, Parramatta's total office stock count has been reduced by 22,404m² since the beginning of 2013, 58% (or 12,902m²) of which has come from change of use. Looking ahead however, the hiatus in supply is expected to be short lived with a material upswing anticipated over the next five years, which will come as welcome news to the market.

Potential supply has been in the pipeline for a number of years and continues to be centred upon the Parramatta Square precinct. The first stage of the development at 169 Macquarie Street (1PSQ) is under construction having achieved a 26,000m² pre-commitment from the University of Western Sydney (UWS), who will occupy the whole building. The site is due for completion in early 2017. Stage 3 at 153 Macquarie Street (24,000m²) is yet to be formally announced, however market speculation suggests the project is likely to imminently progress. Also within Parramatta Square are stages 5 and 6 which is set to provide 126,000m² across two towers, however the timing remains unclear.

Other notable projects include the refurbished backfill space at 1-3 Fitzwilliam Street (9,785m²) which is due for completion in the second quarter of 2015. Raffles Education will occupy two thirds of the building (as owner occupier). 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). A further three major projects are likely to come to fruition from 2018 onwards.

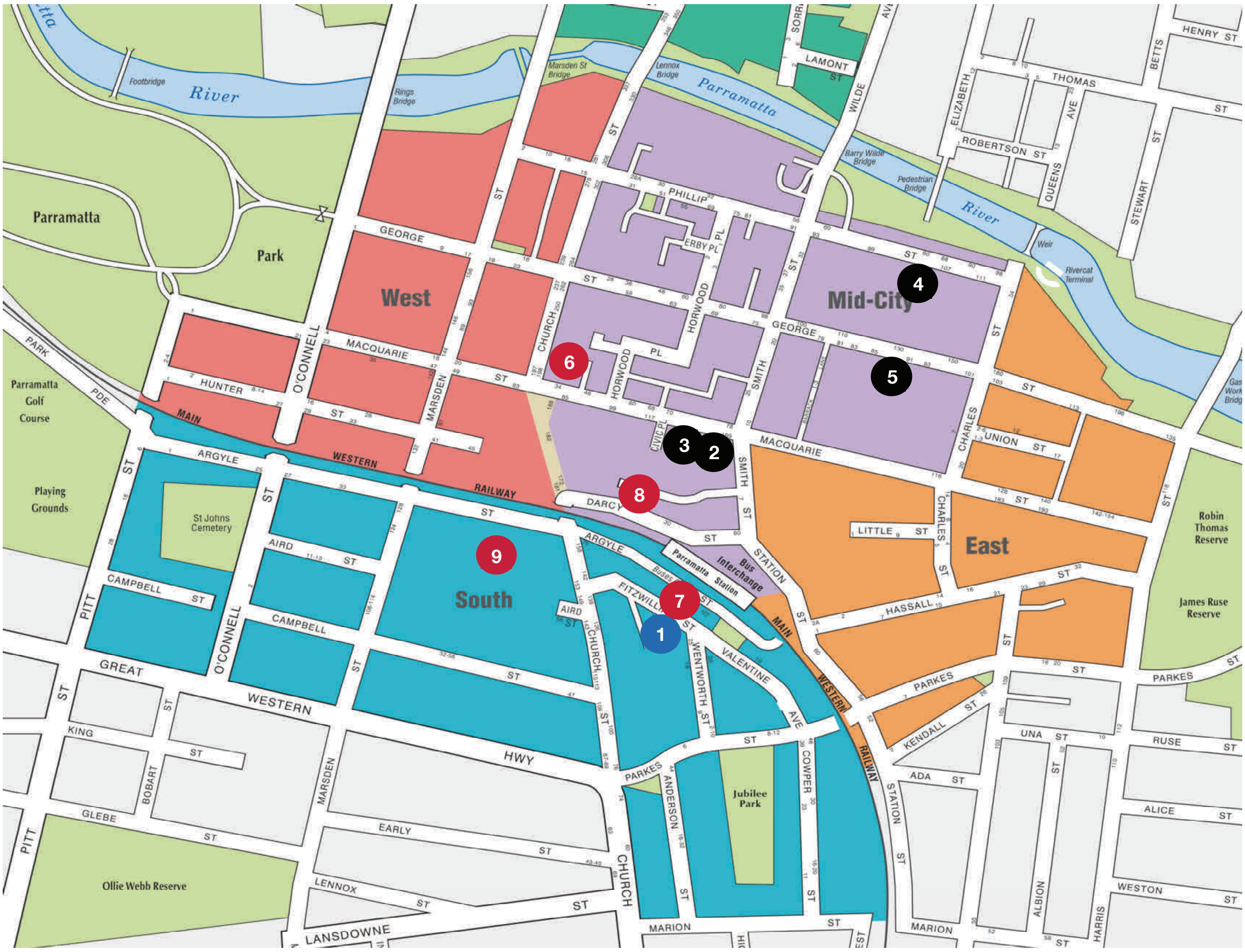
Unlike other suburban markets in NSW, only a limited number of buildings have been withdrawn for residential or mixed use purposes with the bulk of residential development occurring outside of the CBD. As mentioned previously, change of use withdrawals have totalled 12,902m² over the past two years and includes the recently acquired Cumberland Press site at 142-154 Macquarie Street (4,000m²). This in turn has led to a greater concentration of office stock within the CBD, with the intention to not compromise the integrity of the core office market.

TABLE 1
Parramatta Office Market Indicators as at March 2015

Grade	Total Stock (m²)^	Vacancy Rate (%)^	Annual Net Absorption (m²)^	Annual Net Additions (m²)^	Avg Gross Face Rent ($/m²)	Outgoings ($/m²)	Average Incentive (%)*	Average Core Market Yield (%)
Prime	273,617	0.8	-866	0	527	112	21.6 (net)	7.50-9.00
Secondary	406,700	10.0	-6,370	-5,561	424	108	25.0 (gross)	8.75-10.00
Total	**680,317**	**6.3**	**-7,236**	**-5,561**				

Source: Knight Frank/PCA   ^ as at January 2015

MAJOR OFFICE SUPPLY



Source of Map: Knight Frank

1. 1-3 Fitzwilliam St# - 9,785m² [Raffles as owner occupier]
ICUC Holdings - Q2 2015 - 66% committed
2. 1PSQ, 169 Macquarie St^ - 26,000m² [UWS]
Leightons/Charter Hall - early 2017 - 100% committed
3. 153 Macquarie St^ - 24,000m²
Parramatta City Council - H1 2017
4. 105 Phillip St - 20,000m²
DEXUS - 2017+
5. 89 George St - 11,567m²
Webb Property - 2017+
6. Greenway Arc, 48 Macquarie St - 27,500m²
Drivas/Telado - 2017+
7. 2 Fitzwilliam St - 16,260m²
Transport for NSW - 2017+
8. Parramatta Sq. Stages 5 & 6^ - 126,000m²
Parramatta City Council - 2018+
9. Westfield, 159 Church St - 34,000m²
Westfield - 2018+

Under Construction/Complete

DA Approved / Confirmed / Site Works

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

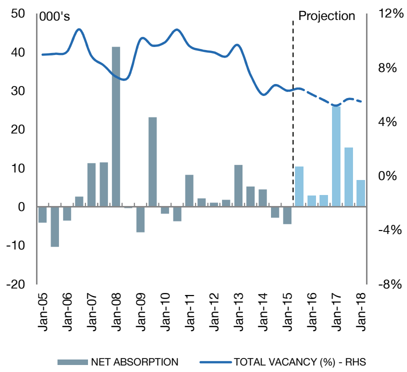
TENANT DEMAND & RENTS

The vacancy rate in Parramatta declined from 6.7% to 6.3% in the six months to January 2015. This reduction was predominantly a reflection of stock withdrawals that offset the negative net absorption recorded during the period. The divergence between prime and secondary markets remains, with secondary stock constituting the bulk of market vacancies. As at January 2015, the vacancy rate in the prime market measured 0.8% (2,316m²), compared with the secondary market where the vacancy rate is significantly higher at 10.0% (40,610m²).

Historically net absorption in Parramatta has been driven by the supply cycle, and to this effect, the absence of recent supply completions and the lack of prime leasing options partly contributed to the fall in occupied space. In the 12 months to January 2015, net absorption in Parramatta measured −7,236m², which was largely the result of tenant relocations from buildings that have undergone change of use (notably, News Ltd at 142-154 Macquarie Street). For the prime market, negative net absorption was recorded for the first time since July 2012, which aligns with an extended period of weak supply.

Over the past 12 months, the majority of new lease deals have stemmed from smaller private tenants with a modest improvement in business conditions in NSW slowly starting to gain some momentum. While large suburban tenant pre-commitments were rare during 2014, a number of major enquiries for prime, non-CBD facilities have been circulated in recent months. The bulk of this enquiry has stemmed from the Finance and Education sectors as well as Government departments looking to decentralise from the Sydney CBD.

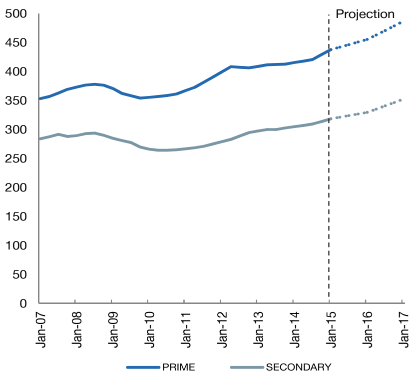
FIGURE 1
Net Absorption & Vacancy
By Grade



Source: Knight Frank/PCA

Tenant churn and an increase in demand for suburban office space is likely over the next two years following the recent acquisitions of office assets for residential change of use. The bulk of these conversions have been concentrated in suburban markets where supply has been weak (Ashfield, Burwood and Epping). Once these buildings are withdrawn, competition for other suburban office markets will increase. In this case, Parramatta is well placed to capture a share of this relocating demand (see page 6).

FIGURE 2
Average Gross Effective Rent
Parramatta by Grade ($/m²)



Source: Knight Frank

Parramatta continues to be one of the national stand out performers in terms of rental growth. Over the past 12 months, the sustained tight A-grade market has resulted in average prime net face rents of $415/m² ($527/m² gross), which reflects an annual growth rate of 6.2%. The majority of this growth has come from renewals, however a number of new buildings including Eclipse has lifted the quality of stock in the prime market. A minor reduction in net incentives was recorded, however they continue to range between 20.0% and 22.5% (net).

Despite weaker leasing conditions within the secondary market, net face rents have experienced annual growth of 5.3% to $316/m², while secondary gross incentives have remained steady at 25.0%. The uplift in rental growth in the secondary market reflects the repositioning of some secondary assets and tenants willingness to pay a premium for refurbished space.

A lack of available leasing options in the prime market is expected to result in average rental growth of 3.75% over the next two years before the increase in supply towards the end of 2016 comes to fruition. Similarly, prime incentives are anticipated to gradually reduce, however the extent of this is constrained by higher incentives in other competing markets. The repositioning of secondary assets is expected to result in sustained growth of 3.5% per annum over the next two years.

TABLE 2
Recent Leasing Activity Parramatta

Address	NLA (m²)	Face Rental ($/m²)	Term (yrs)	Tenant	Date
18 Smith Street	2,518	420n	7	Employers Mutual	Feb-15
3 Horwood Place	177	479g	6	Cushman & Wakefield	Jan-15
87 Marsden Street	948	360n	3.5	Office of State Revenue	Dec-14
2 Wentworth Street	962	400n	10	NSW Police	Dec-14
91 Phillip Street	940	375n	5	KPMG	Nov-14
3 Horwood Place	367	340g	7	PSK Financial Services	Oct-14

Source: Knight Frank n refers net g refers gross *Department of Education & Communities

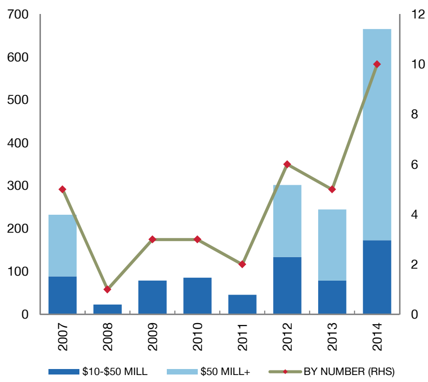
INVESTMENT ACTIVITY & YIELDS

The flow of investment activity to non-CBD office markets has continued, with sales volumes trending at historical highs. Parramatta has been no exception to this trend, with the cheaper cost of debt assisting a surge in both the number of assets exchanged and sales volumes by value during 2014. Over the 12 months to December 2014, sales volumes ($10 million+) in Parramatta totaled $666 million (excluding the 1PSQ sale* - refer back page), across 10 transactions.

Assets priced at $50 million and above dominated sales volumes during 2014, accounting for 74% of this volume. Previously, Parramatta's prime 'trophy' assets were tightly held, however favourable selling conditions meant that two of Parramatta's landmark buildings were traded during 2014 (1 Charles Street and the Justice Precinct Offices).

The largest sale in recent months was the Justice Precinct office component at 160 Marsden Street and 4 George Street. The assets were bought by Eureka Funds Management for $170.1 million. This asset coupled with the June acquisition of 1 Charles Street (NSW Police) highlight the market premium for upper prime assets with 10+ year WALEs, with such assets being further progressed through the yield firming cycle compared to the broader A-grade market. This suggests that there is a large inconsistency between yields in the broader A-grade market, with quality of stock and WALE playing a crucial role.

FIGURE 3
Parramatta Office Transactions
$10million + by Value and Number

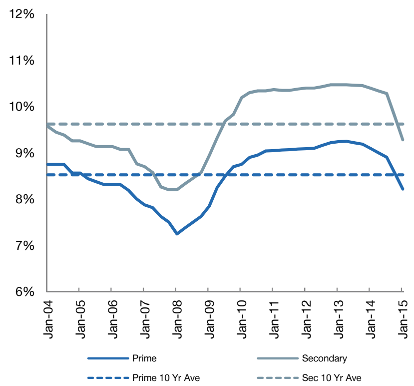


Source: Knight Frank/PCA
Note: excludes the 1PSQ acquisition

Other notable recent sales include the sale of 87 Marsden Street for $33.15 million. Although the asset traded on a core market yield of 7.4%, this reflected the year 1 expiry of 45% of the buildings NLA. Market speculation suggests this lease will be renewed given limited alternate options, while it is understood the purchaser likely focussed on the initial yield of 8.3%.

While yield firming in the Parramatta market between 2013 and mid 2014 was largely confined to the upper prime market, the recent sales of smaller A and B grade assets has resulted in yield compression of approximately 100bps across the broader market over the past 12 months. Average yields (based on a 5 year WALE) now range between 7.50% and 9.00% for prime and 8.75% and 10.00% for secondary. The recent firming of 88bps and 111bps respectively over the past year has meant that yields for both prime and secondary markets are below their 10 year averages.

FIGURE 4
Average Core Market Yields
Parramatta by Grade(%)



Source: Knight Frank

Looking ahead, sales volumes are expected to ease unless some of the new builds are pre-sold. Almost all major buildings in Parramatta have been sold over the past 2 years, which is likely to result in prime assets becoming more tightly held. However, further yield compression is anticipated as investors become more aggressive in their approach to secure such assets.

TABLE 3
Recent Sales Activity Parramatta above $10 million

Address	Price ($ mil)	Core Mkt Yield (%)	NLA (m²)	$/m² NLA	WALE (yrs)	Vendor	Purchaser	Sale Date
3 Horwood Place	25.40	8.0	5,013	5,067	2.1	MAB Diversified Property Trust	IOOF	Jan-15
90 Phillip St	16.75	6.4+	2,944	5,690	N/A	Mevote	Local developer	Dec-14
160 Marsden St & 4 George St ^	170.10	Conf.	21,587	7,880	15.0	Govt. Property NSW	Eureka Funds Management	Dec-14
87 Marsden St	33.15	7.4	6,704	4,945	2.9	Quintessential	Hilti Group	Dec-14
2-10 Wentworth St	45.05	9.2	10,941	4,118	5.3	Charter Hall Direct Property Fund	Centuria Capital	Dec-14
110 George St	81.68	8.3>	20,956	3,897	3.4	Westlawn/Charter Hall#	Longbow Enterprises	Oct-14
460 Church St	24.00	10.5<	7,545	3,181	2.0	Bennelong	Dyldam	Aug-14

Source: Knight Frank > risk adjusted # Charter Hall's PFA Diversified Property Trust and Westlawn Property Trust ^ Justice Precinct Offices
< Initial yield Conf.: Confidential + Fully leased initial yield

RESIDENTIAL DEVELOPMENT

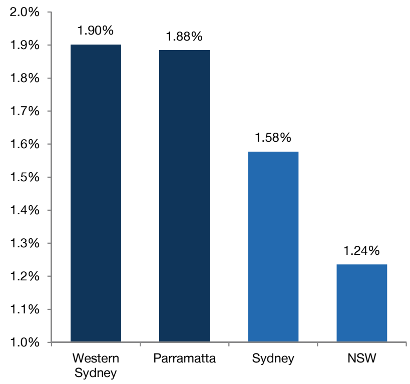
Situated approximately 24km from the Sydney CBD, Parramatta has been subject to strong residential developer demand over the past three years. This increase comes in response to rising dwelling values and increased demand for higher density living which has encouraged other developers into the area. The pipeline of apartments either under construction or proposed is significant and comes off the back of recent Government commitment and initiatives which recognise Parramatta as Sydney's second CBD.

Accordingly, given Parramatta's geographic position within Western Sydney, it is set to become the focal point for employment, residential, cultural and educational opportunities. At present, a large share of Western Sydney residents must leave the region for work. However increased investment from both public and private sectors will encourage employment growth within the area, ultimately leading to an uplift in demand for office space at Parramatta. Examples of recent Government spending and commitment to Parramatta includes the shortlisting of four potential routes for the Parramatta Light Rail project.

FIGURE 5

Projected Annual Average Population Growth Rates

2011 - 2031



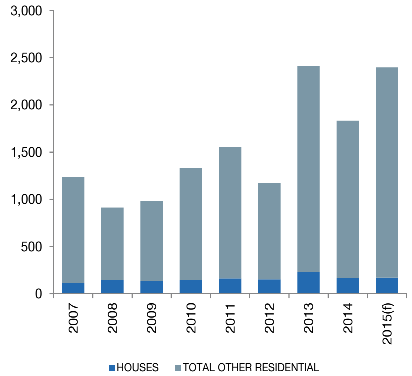
Source: NSW DP&E

Population growth in Parramatta has been solid over the past decade, growing at an average annual rate of 2.3% in comparison to the Greater Sydney average of just 1.3%. The superior growth was underpinned by continued high levels of net overseas migration and the gravitation of these people to middle and outer ring areas. Looking ahead, the bulk of Sydney's population growth is expected to stem from Sydney's growth corridors of the North and South West, where Western Sydney is projected to account for 58% of Sydney's future growth. On an annual basis, population growth in Western Sydney over the next 20 years is expected to average 1.90% per annum, slightly above Parramatta (1.88% per annum) and considerably higher than Sydney and NSW projections (1.58% and 1.24% per annum respectively).

FIGURE 6

Residential Approvals, Parramatta

By Dwelling Type and Number



Source: ABS, Knight Frank
Note: 2015 is a Knight Frank forecast

Dwelling approvals in Parramatta have been substantially under the rate of population growth over the past decade.

TABLE 4 MAP 1

Current & Potential Apartment Projects in Parramatta (100+ apartments)

	Address	Developer	Apartments
1	111 George Street	Dyldam	265
2	180 George Street	Meriton	146
3	330 Church Street	Meriton	636
4	45 Macquarie Street	Crown International	515
5	29 Hunter Street	Toplace	108
6	36 Cowper Street	Sonenco	220
7	9-11 Hassall Street	Z&WP	164
8	1a Morton Street	JQZ	350
9	2 Morton Street	Starryland Australia	774
10	142 Macquarie Street	Dyldam	550
11	14-16 Phillip Street	Lidis	413
12	197 Church Street	Holdmark	150
13	160 Church Street (Aspire)	N/A	700
14	76-100 Church Street	N/A	364
15	83 Church Street	Boyded	779
16	23-29 Hassall Street	Mamoun	163
17	189 Macquarie Street	Toplace	425
18	18 Hunter Street	SH International	393

Source: Knight Frank   Under construction/imminent   Proposed   Note: yellow dotted line indicates CBD commercial core

From 2007 to 2009, the building response to sustained high levels of population growth was subdued with total approvals averaging just 950 per annum. This environment led to widespread housing shortages, reflected by rental growth of 19% over the 12 months to December 2008 (see figure 7 below).

However, favourable underlying fundamentals, changing household preferences (more lifestyle focused) and a pronounced shift in Sydney's demographic structure has underpinned the significant uplift in Parramatta's residential development. Over the two years to 2014, approvals have averaged 2,126 per annum, which is 1.5 times larger than the average recorded since 2007. The recent upturn has been facilitated by an increase in apartment approvals, which have accounted for 92% of total approvals since 2013.

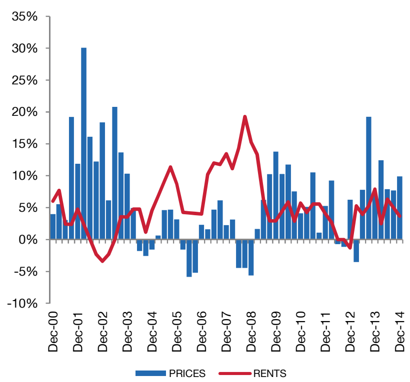
Despite the surge in apartment construction, the commercial core of the Parramatta CBD has remained office focused, with residential development predominantly occurring on the fringe of the CBD (as the yellow dotted line in Map 1 indicates). By focusing residential development on the fringe, the commercial core will remain the key articulation point in Parramatta, while being bookended by a growing population.

In total, Knight Frank has identified 18 residential and mixed use projects either underway or in the planning stage on the fringe of the CBD. Collectively, these projects are set to provide approximately 7,100 apartments over the next five years. At an assumed household density of 2.1 persons per apartment, this equates to an additional 14,910 residents in walking distance to the CBD. Notable projects include the Meriton development of 330 George Street and Aspire tower as part of Parramatta Square. Collectively these projects alone are set to include 1,300+ apartments.

New residential development is expected to have several positive implications to Parramatta and the office market. From a utilisation perspective, a larger resident population is anticipated to result in greater demand for employment and a focus of Government spending, giving local residents the ability to work closer to where they live (and therefore fulfilling a state Government objective). Alternatively, compared to office workers, permanent resident spend extends beyond working hours, effectively providing more support for retail provisions, leading to a more prosperous local economy.

In addition to economic benefits, there are a number of social benefits that will be achieved from residential development including enhanced aesthetics, street activation and improved security from new city residents. The estimated 14,910 additional residents living in the immediate area over the next five years will activate Parramatta, particularly after traditional working hours. This will ultimately increase natural surveillance, providing a safer environment for both workers, residents and visitors alike.

FIGURE 7
Apartment Price & Rental Growth
Parramatta, Annual Rolling Average



Source: NSW Department of Housing

Outlook

- Following a three year hiatus in supply, Parramatta is poised to experience a material uplift in supply over the next five years, underpinned by the Parramatta Square development.
- Given that new office supply is not expected until early 2017, the tight prime market is expected to prevail. This will provide scope for further rental growth in the order of 3.75% over the next two years. Incentives are anticipated to continue their downward trend. However, the extent of the reduction remains capped by higher incentives in other office markets.
- The outlook for growth in tenant demand is favourable. A number of large tenant briefs for suburban office space have been circulated in recent months which has the potential to underpin the supply cycle. At the same time, demand will also be drawn from tenant relocations in other suburban markets as buildings are withdrawn for change of use.
- Parramatta has also been subject to significant residential development, however the bulk of this has occurred outside the commercial core, with just 12,909m² of stock withdrawn for change of use since the beginning of 2013.
- The associated increase in the local population is expected to further strengthen the local economy through an increase in both public and private investment.
- With an increase in both domestic and global capital seeking higher yielding assets, it is likely that buyer depth for office assets in Parramatta will remain solid. However given that almost all major buildings have been traded in recent years, it is likely prime assets will become more tightly held. This is likely to result in a reduction in sales volumes during 2015, unless some new builds are pre-sold.

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* In December, two of Charter Hall's managed funds acquired the 1PSQ site (pre-committed to UWS) for $16.25, where in conjunction with Leighton Properties, $220.5 million will be spent in developing it over the next 2 years. Given that it was sold as a development site, we have excluded the sale from the sales volumes figures.

Definition:
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).

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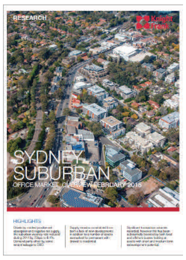

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