

PARRAMATTA

OFFICE MARKET BRIEF MARCH 2017



Key Facts

As at January 2017, Parramatta's overall vacancy rate measured 4.3%, with nil vacancy recorded in the prime market.

Stage 1 of Parramatta Square is now complete and signifies the beginning of Parramatta's next supply cycle.

Rental growth has been significant with prime and secondary effective rents increasing by 8.6% and 10.1% respectively over the past year.

Yields continue to tighten however the rate of firming has been most pronounced in the secondary market.



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A lack of available prime space and limited large contiguous options in the secondary market is creating opportunities for new entrants into the pre-commitment market. Following the 100% occupation of 1PSQ, the vacancy rate is at its lowest level since January 1990.

Development Activity

Following an extended period of limited construction activity, gross office supply in Parramatta is currently at its highest level since January 2008 with 26,000m² of new space added to the market in the second half of 2016. Notably, new supply over the period stemmed solely from the completion of the first stage of Parramatta Square (1PSQ—169 Macquarie Street) in late 2016 which has become home to Western Sydney University's (WSU) Parramatta City Campus. Initially pre-committing to the entire building, WSU have subleased 1,400m² and 4,000m² to PwC and Water NSW respectively on the upper floors of the building.

On a net basis, the withdrawal of office stock for alternative uses continues to impact stock levels, albeit less than other Sydney markets. In the six months to January 2017, 1,370m² of stock was permanently withdrawn from one building, 23-27 Macquarie Street. Subsequently, net supply over the period totalled 24,630m². More recently, 86-102 Church Street (3,291m²) has been withdrawn from the market to make way for a residential project.

Looking forward, a pick-up in supply is anticipated over the next two years. DEXUS has begun construction at 105 Phillip Street, due for completion in Q2 2018. Once complete, the site will house the Department of Education, which will relocate from the Sydney CBD as part of the NSW Government's decentralisation policy. At the Parramatta Square precinct, groundworks have commenced at 3PSQ with NAB recently pre-committing to 43,000m² from mid 2020. The NSW Government has also announced their pre-commitment for more than 63,000m² at 4PSQ, bringing together offices of the Department of Planning, Environment Protection Authority and the Department of Finance from various locations across Sydney from mid 2019.

In addition, the acquisition of the Salvation Army site at 93 & 95 Phillip Street and 32 Smith Street by GPT in late 2016 is expected to result in a further 26,400m² of office supply being added to the market by 2020+ pending pre-commitments. Beyond this, the supply pipeline includes 6PSQ (45,000m²) and Westfield potentially adding up to 100,000m² of office space.

Net Absorption & Vacancy

Despite a boost in supply over the past six months, the Parramatta vacancy rate has continued to tighten as new supply has been fully committed on completion. As at January 2017, the Parramatta vacancy rate measured 4.3%, well below the 10 year average of 7.9% and the lowest level since January 1990.

The lack of stock is most apparent in the prime market where there is no vacant space, making it the tightest prime office market in the country. With no prime space available, new market entrants or existing tenants seeking expansionary space are being forced to pre-commit or move to the secondary market where the vacancy rate is higher at 7.5%.

Following the 100% occupation of 1PSQ in late 2016, net absorption figures are currently at their highest level since 2007 with 24,546m² of office space taken up over the six months to January 2017. Most importantly, the strong leasing activity over the past 12 months has been driven by tenant expansion and relocation from other markets into Parramatta,

contributing to the positive absorption and not creating any backfill space locally. Major deals included Western Sydney University (WSU) taking the head lease over 1PSQ for their flagship Parramatta City Campus and subletting the upper floors to PwC (1,400m² – relocating from Norwest) and Water NSW (4,000m² – relocating from Penrith).

Highlighting this has been growth in business counts, where in the two years to June 2016 (ABS- latest available data) there were 184 additional employing businesses operating in Parramatta, underpinned by professional services (+74 businesses). Notably, this indicates growth of 10.3% over the two years to June 2016, well above the 2.0% recorded for the Sydney CBD over the same period.

With a number of Government and large corporate occupiers seeking prime space in Parramatta, the pre-commitment market has been active over the past six months. Notable deals include NAB agreeing to lease 43,000m² at 3PSQ from Q1 2020 and GPNSW committing to 63,000m² at 4PSQ from mid-2019, making it one of the largest pre-commit deals in the country.

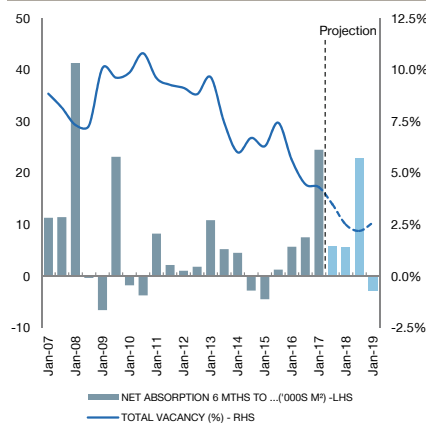
The secondary market continues to have steady leasing activity but due to the lack of large contiguous options, activity has been constrained to smaller deals. The only prominent secondary deals to occur are HCF taking 1,800m² of space on the newly refurbished top floor of 75 George Street and Westpac renewing its lease (3,119m²) at 80 George Street.

Rents & Incentives

Favourable leasing market conditions, coupled with the tight vacancy rate, has ensured strong face rental growth for both the prime and secondary markets. In conjunction with a gradual fall in incentive metrics, effective rental growth is at its highest level in years.

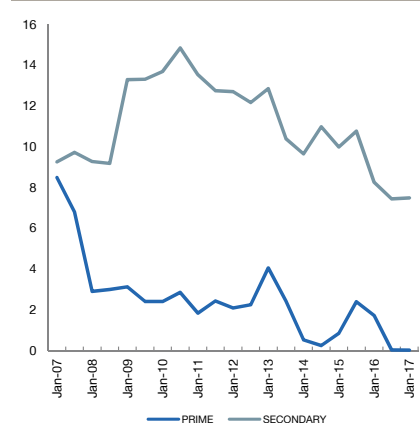
With the prime grade vacancy rate remaining at 0% over the past year, average prime gross face rents have increased by 5.6% over the past 12 months to average \$580/m² (\$469/m² net). Although asset specific, average prime incentives have continued to fall across the board, down to 18.4% from 21.5% a year ago, as landlords take advantage of current market conditions. As a result, prime gross effective rental growth has totalled 8.6% over the past 12 months.

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



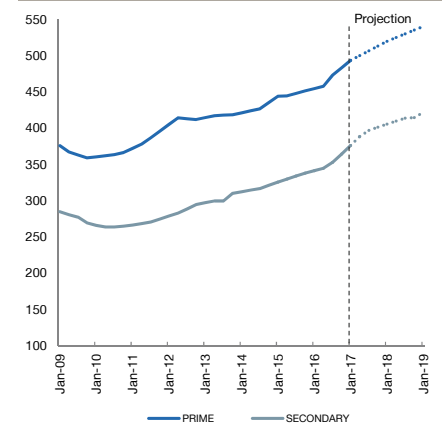
Source: Knight Frank Research/PCA

FIGURE 2
Parramatta Vacancy
Total vacancy by grade (%)



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 January 2017

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 Net Incentive (%)	Average Core Market Yield (%)
Prime	299,617	0.0	30,647	26,000	580	111	18.4	6.00 - 7.00*
Secondary	407,482	7.5	1,481	-1,808	485	115	22.5	6.75 - 7.50
Total	707,099	4.3	32,128	24,192				

Source: Knight Frank Research/PCA

* Upper prime assets with long WALEs are trading below this range (sub 6.0%)

With a vacancy rate of 7.5% in the secondary market, tenants that wish to remain or move to Parramatta in the short to medium term are being encouraged to consider the secondary market to satisfy their tenancy requirements. As a result, gross face rental growth in the secondary market has increased 6.6% over the past 12 months, to currently average \$485/m² gross (\$376/m² net). With incentive levels declining from 25% a year ago to be 22.5%, gross effective rental growth in the secondary market has outstripped that of the prime market, increasing 10.1% to currently average \$376/m².

Investment Activity & Yields

Impacted by a scarcity of investment opportunities rather than a lack of demand, office investment volumes (\$10m+) in Parramatta for 2016 are 65% down from the peak in 2014. However, aided by two sales towards the end of 2016, investment volumes are up 12.3% from 2015 levels to total \$243.1 million for the period. For 2017, the only sale to occur to date is the purchase of the Salvation Army site at 93 & 95 Phillip Street/32 Smith Street for \$31.2 million, which is earmarked to be redeveloped to accommodate a potential office GFA of 28,048m².

Domestic unlisted funds and syndicates accounted for 57% of sales during 2016, underpinned by the sale of 18 Smith Street for \$84.03 million. This sale, purchased by Eureka Funds Management, was the largest transaction for 2016 and reflected a core market yield of 6.80%. The other notable sale, by local unlisted fund PFA Diversified Property Trust (Charter Hall) was the purchase of 9 Wentworth Street in early 2016 for \$42.2 million.

TABLE 2

Recent Leasing Activity Parramatta

Address	NLA (m ²)	Face Rental (\$/m ²)	Term yrs	Lease Type	Tenant	Date
105 Phillip St	25,000	545n	10	Pre-com	Dept. of Education	Mar-18
One Parramatta Sq.	26,500	540n	15	Pre-com	WSU	Dec-16
80 George St	3,119	395n	5	Renewal	Westpac	Oct-16
80 George St	260	420n	3	New	Pivotal Aust.	Sep-16
56 Station St	1,106	385n	3	New	GPNSW	Sep-16
9 Wentworth St	4,735	470n	7	New	Dept. of Immigration	Sep-16

Source: Knight Frank Research n refers net

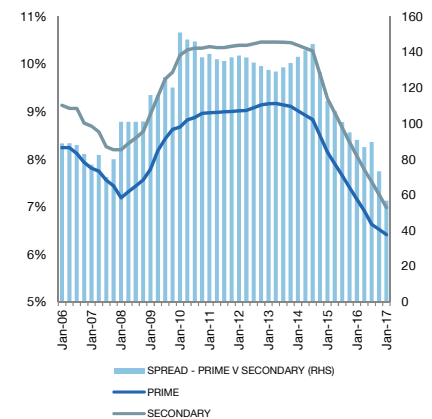
Notably in 2016, the Parramatta market saw the inflow from offshore groups remain strong, representing 22% of sales over the period (by volume), moderately above the long term average of 16%. The buoyant demand from offshore groups can be attributed to fewer core assets being brought to market in the CBD which has seen offshore groups increasingly seek suburban office assets to satisfy their investment mandates. The only offshore acquisition during 2016 was the late 2016 sale of 80 George Street for \$51.88 million to a Chinese private investor.

Buoyed by Parramatta's rental outlook, yields have continued to compress across the prime market, evidenced by the sale of 80 George Street which traded on a core market yield of 6.76% (WALE of 3.3 years). Average prime yields have tightened by 74 bps over the past 12 months to currently average 6.42%. However, an upper prime asset with a 10+ year WALE would likely trade at sub 6.0%. The current offering of DEXUS' under construction 105 Phillip Street with a 12 year WALE will provide further clarity to upper prime yield metrics for assets with this tenure/covenant once sold.

Meanwhile, driven by opportunistic purchasers seeking value add opportunities through rental reversions, the rate of yield compression in the secondary market has totalled 109 bps over the past 12 months to now average 6.98%. Following this, the current spread between prime and secondary yields is at all time lows at 57 basis points (see Figure 4).

FIGURE 4

Average Core Market Yields Parramatta (%)



Source: Knight Frank Research

TABLE 3

Recent Sales Activity Parramatta (\$10m+)

Address	Price (\$ mil)	Core Mkt Yield (%)	NLA (m ²)	\$/m ² NLA	WALE (yrs)	Vendor	Purchaser	Sale Date
93 & 95 Phillip St/32 Smith St~	31.20	-	566*	-	-	The Salvation Army	GPT	Jan-17
41-59 George St ~	23.00	-	2,230	-	-	Private	Holdmark	Dec-16
80 George St	51.88	6.76	8,196	6,330	3.3	GDI Property Group	Private Offshore Investor	Oct-16
18 Smith St	84.03	6.80	12,062	6,966	3.7	Altis Property	Eureka Funds Mgmt	Aug-16
126 Church St	42.00	8.30	9,809	4,284	2.2	Gemroll Pty Ltd	Marprop	May-16
9 Wentworth St	42.20	6.90	7,682	5,495	6.5	Charter Hall>	Charter Hall Office Trust	Mar-16

Source: Knight Frank Research

~ Site was bought for redevelopment

* Excludes The Salvation Army NLA

>PFA Diversified Property Trust

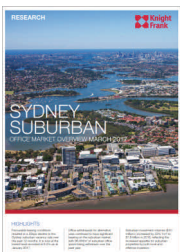


Outlook

- The strong supply pipeline is expected to continue over the next five years on the back of a number of significant pre-commitments by Government tenants and large corporations. Supply is expected to be 109% above average historical levels over the next five years.
- Government departments will continue to dominate the large space enquiry across the market with the Department of Transport, OSR, Department of Planning and Department of Industry all potentially seeking to consolidate offices in the Parramatta CBD.
- Net absorption in Parramatta over the next five years is forecast to be around 30,000m² per annum, more than double the 10 year average of around 12,000m² per annum due to the continued inflow of tenants from other locations.
- With the majority of future developments in Parramatta being pre-committed by tenants relocating from other markets, we anticipate vacancy will remain tight, particularly for prime space, over the next two years. This will see the overall vacancy rate in the Parramatta CBD trending down towards 2.5% by the end of 2018.
- Rental growth is anticipated to remain strong, with gross face rents forecast to increase 4.25% per annum for both prime and secondary over the next two years. Incentive metrics are forecast to fall to 17.5% for prime and 20% for secondary by the end of 2018.
- An increase in sales volumes is expected in 2017 with the current offering of 105 Phillip Street likely to exceed all 2016 sale volumes combined. Yield levels are expected to firm further, albeit below the rate seen over the past two years.

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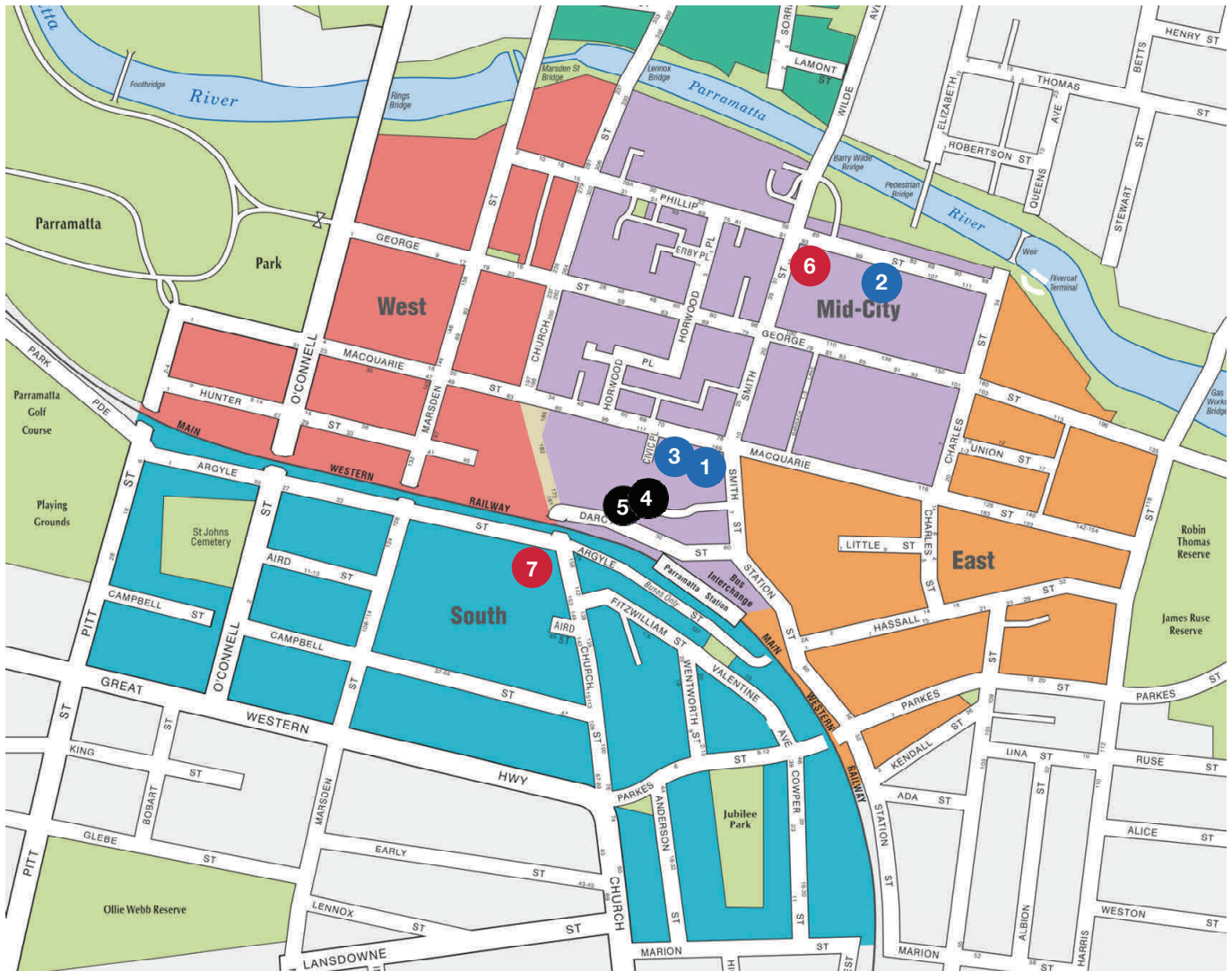
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MAJOR OFFICE SUPPLY



Source of map: Knight Frank

- 1 1PSQ, 169 Macquarie St[^] - 26,000m² [WSU, PwC, Water NSW]
Charter Hall - 2016 - Complete
- 2 105 Phillip St - 25,000m² [NSW Department of Education]
DEXUS - March 2018 - 100% committed
- 3 Parramatta Sq. Stage 4[^] - 63,000m² [NSW Government]
Walker Corporation - Mid 2019
- 4 153 Macquarie St (Parramatta Square Stage 3)[^] - 43,000m² [NAB]
Walker Corporation - Mid 2020
- 5 Parramatta Sq. Stage 6[^] - 45,000m²
Walker Corporation - 2021+
- 6 93 & 95 Phillip St & 32 Smith St - 28,048m²
GPT - 2019+
- 7 Westfield, 159 Church St - 35,000m²§
Westfield - 2020+

- 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 pre-commitment in [brackets] next to NLA
[^] Part of Parramatta Square project
§ Westfield is applying to increase area to 100,000m²