RESEARCH

Knight Frank

OCTOBER 2013

# WEST PERTH

Office Market Brief

## HIGHLIGHTS

- The effects of a softening West Perth leasing market during late 2012 have materialised in 2013 with the first half of the year recording net absorption of negative 5,720m$^2$. As a result, vacancy rates rose to an eight year high of 7.6% (from 4.5% in January) which was predominantly evident in Secondary-grade assets recording 9.9% vacancy.
- Incentive levels across the board have risen to circa 15% which is expected to favour tenant migration to higher quality premises. While overall tenant demand has declined, demand for Prime-grade office space is resilient with smaller tenants seeking more desirable leasing options. Most tenants, however, will act cautiously while uncertain about their leasing requirements. Rental levels have fallen during the 2013 year to date with forecasts indicating negative face rental growth over the next twelve months.
- Two major transactions occurred in West Perth over the last six months totalling $22.05 million. Core market yields for Prime-grade buildings on average range from 8.25% to 8.75%, while Secondary-grade properties are yielding an average range of 8.75% to 9.25%. Yields have remained fairly static since September 2012.

Table 1
West Perth Office Market Indicators as at October 2013

| Grade | Total Stock ($m^2$)^ | Vacancy Rate (%)^ | Annual Net Absorption ($m^2$)^ | Annual Net Additions ($m^2$)^ | Average Net Face Rent ($/$m^2$) | Average Net Incentive (%) | Average Core Market Yield (%) |
|---|---|---|---|---|---|---|---|
| Prime | 133,607 | 2.7 | 2,605 | 4,668 | 500 - 575 | 15.0 | 8.25 – 8.75 |
| Secondary | 280,582 | 9.9 | -2,124 | 14,169 | 400 - 475 | 15.0 | 8.75 – 9.25 |
| **Total** | **414,189** | **7.6** | **481** | **18,837** | | | |

Source: Knight Frank ^PCA OMR as at July

## Supply & Development

The PCA recorded net supply additions to the West Perth area of 7,328$m^2$ in the six months to July 2013. This level of supply represents 1.8% of stock, a rate that exceeds the 20 year average of 0.6%.

Of these net additions, 6,516$m^2$ comprised of new development and includes 1,848$m^2$ at 34 Parliament Place, which was completed in quarter one 2013, as well as, 100 Havelock Street, which saw 4,668$m^2$ of new supply enter the market during the second quarter of 2013. In addition, partial refurbishments were completed at 35 Havelock Street totalling 812$m^2$. No stock was withdrawn from the market during the equivalent period.

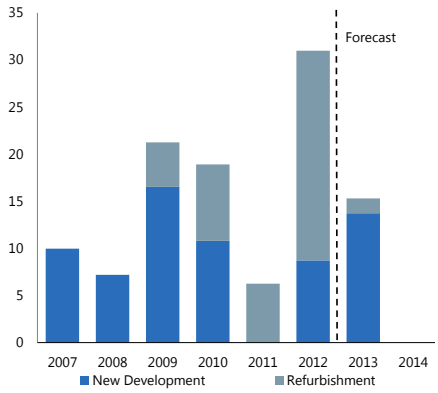
Table 2
West Perth New Development

| Address | NLA ($m^2$) | Estimated Completion |
|---|---|---|
| 1 Ord Street | 3,488 | Q3 2013 |
| 1101 Hay Street | 2,264 | Q4 2013 |
| 1160 Hay Street | 1,500 | Q4 2013 |
| 11-13 Lucknow Place | 765 | Q4 2013 |
| **Total** | **7,977** | |

Source: Knight Frank/PCA

It is anticipated that 7,977$m^2$ of new supply will enter the West Perth market during the second half of 2013, taking the yearly total to 15,305$m^2$. This represents a 50% reduction in supply from that seen in 2012 which totalled 30,963$m^2$. The majority of new supply will comprise new development including 3,488$m^2$ at 1 Ord Street, which is due for completion in quarter three 2013. 1101 Hay Street and 1160 Hay Street are both due for completion in quarter four 2013 and will deliver 2,264$m^2$ and 1,500$m^2$ of new supply respectively. In addition, 765$m^2$ of fully refurbished NLA, at 11-13 Lucknow Place, will come online in late 2013. One mooted project comprising 1,414$m^2$ at 957-959 Wellington Street remains in the pipeline. There is currently no supply under construction or being refurbished that is due for completion in 2014 and beyond.

Figure 1
West Perth Office Supply
New and Refurbished Stock ('000$m^2$)

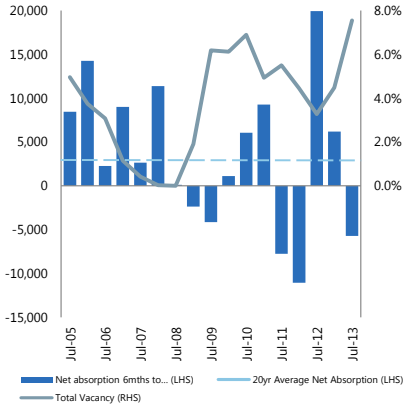



Source: Knight Frank/PCA

## Net Absorption & Vacancy

Negative net absorption was recorded by the PCA for the six months to July 2013, totalling -5,720$m^2$, which is the first contraction since the second half of 2011. Negative demand, however, only occurred within the secondary market (-8,516$m^2$). Prime-grade office space recoded positive demand with A-grade absorption equating to 2,796$m^2$, an indicator that tenants are looking to take advantage of elevated incentives and upgrade their premises.

Figure 2
West Perth Vacancy and Net Absorption
Per six month period ($m^2$)




Source: Knight Frank/PCA

With negative net absorption in the first-half of 2013, the total vacancy rate increased to 7.6%, which represents a 69% rise from 4.5% recorded six months prior. This is the highest vacancy rate recorded since January 2005.

Prime-grade vacancy reached 3,661$m^2$ representing 2.7% of total prime stock. Within this, direct vacancy experienced the largest increases, rising from 1,480$m^2$ to 3,352$m^2$ over the past six months. Secondary-grade experienced a significant increase in vacancy from 16,453$m^2$ to 27,629$m^2$ which represents 9.9% of total secondary stock. Knight Frank has calculated that the level of space being actively marketed in West Perth was above 9% as at July 2013.

## Rents & Tenant Demand

Leasing activity has been subdued in West Perth over the past six months. Rental levels have been under pressure with incentives growing to average 15% for both Prime and Secondary-grade buildings, increasing from circa 5% and 8.5% respectively. Average Prime-grade net face rents have softened by 4.9% over the past 12 months and currently range between $500/m² and $575/m². Secondary-grade net face rents fell by 9.0% over the same period to a current average range of $400/m² to $475/m².

Table 3
Recent Leasing Activity West Perth

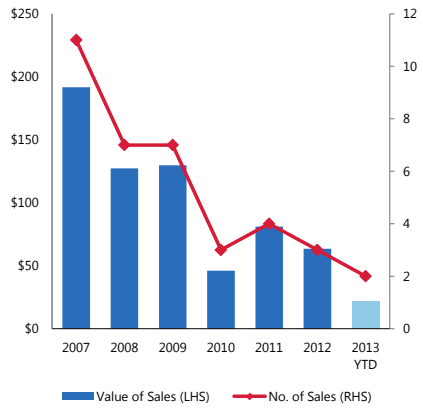
| Address | Area (sq m) | Net face Rental ($/m²) | Term | Tenant | Start Date |
|---|---|---|---|---|---|
| IBM Centre, 1160 Hay St | 886 | 550 | 5 | Amberley Centre | Aug-13 |
| IBM Centre, 1160 Hay St | 204 | 595 | 5 | Objective | Jul-13 |
| 56 Ord Street | 476 | 575 | 2 | Undisclosed | Jul-13 |
| 16 Altona St | 951 | 480 | 7 | Undisclosed | May-13 |
| 27-31 Troode St | 1,050 | 575 | 5 | VDM Construction | May-13 |
| 50 Colin Street | 530 | 565 | 5.5 | Optiro | Feb-13 |
| 41-47 Colin Street | 971 | 500 | 5 | Tap Oil Limited | Feb-13 |

Source: Knight Frank

## Investment Activity

Two transactions (>$10 million) occurred in West Perth during the 2013 year to date totalling $22.05 million. The first transaction was 15-17 Altona Street, which sold in March this year for a total consideration of $11.5 million with a short WALE of 0.9 years.

Figure 3
West Perth Sales Activity
($ million) Sales value >$10 million




Source: Knight Frank

Additionally, 647-659 Murray Street sold for $10.55 million in April this year. The former Clinipath building sold to Finbar as part of a joint venture project with a private investor, with the current improvements to be demolished in June 2014 allowing for construction of an apartment development.

Core market yields for Prime-grade buildings are on average 8.5% with Secondary-grade properties yielding an average of 9.0%. This has remained stable since September 2012.

## Outlook

Tenant enquiry levels indicate net absorption will remain subdued for the remainder of 2013. A newly appointed government, however, with a clear majority, should help reduce the uncertainty that has surrounded prospective tenants and their leasing decisions. As a result, tenant demand is expected to improve marginally, however, not enough to counter the negative net absorption which Knight Frank anticipates over the coming six to twelve months.

The level of available space in West Perth is expected to increase with 7,977m² of new supply forecast to come online by the close of 2013. Consequently, Knight Frank expects the vacancy rate to rise above 10% by January 2014. This, along with subdued demand, should see West Perth vacancy rates increase further over the course of 2014. Thereafter, vacancy is expected to fall due to the lack of new supply entering the market in the medium to long term.

Face rental growth is expected to be negative while incentives are forecast to remain at their elevated levels for the next 12-18 months. Subsequently, and when rents have returned to more sustainable levels, face rental growth will be modest while incentives should decline back to levels prior to the mining downturn at circa 5%-10%.

Investment in West Perth has been marginal with only two acquisitions greater than $10 million recorded during the 2013 year to date. However, this does not accurately reflect the level of investor interest for West Perth properties. The limited number of sales is partly attributable to the tightly held nature of the market and pent-up demand from high net worth individuals and syndicates exists. Looking forward, a combination of historically low interest rates, as well as a circa 13% depreciation of the Australian dollar against the US dollar over the first six months of the year, should provide encouraging signs that demand from both international and local investors will likely gain momentum in 2014.

Table 4
Recent Sales Activity West Perth

| Address | Price ($ mil) | Core Market Yield (%) | NLA (m²) | $/m² NLA | Vendor | Purchaser | Sale Date |
|---|---|---|---|---|---|---|---|
| 647-659 Murray Street # | 10.55 | N/A | Site | # | Clinipath | Finbar Group JV | Apr-13 |
| 15-17 Altona Street | 11.50 | 9.4 | 2,290 | 5,021 | WALGA | BR3 P/L & Trout Holdings P/L | Mar-13 |

Source: Knight Frank #Purchased for residential redevelopment - existing improvements to be demolished in June 2014. Reflected a land rate of $3,094/m²

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