RESEARCH

WEST PERTH

OFFICE MARKET BRIEF OCTOBER 2017

Market sentiment is improving as vacancy levels and leasing incentives show tentative signs of recovery. The main driver of activity continues to be the refurbishment of secondary grade stock.

Key Facts

West Perth office **vacancy fell to 15.0%** as at July 2017 from 17.5% in January 2017.

Positive net absorption of 8,666m² was recorded in the six months to July 2017.

Incentives have stabilised averaging 30% of lease terms.

New office developments in West Perth are unlikely in the short to medium term.

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Development Activity

Development activity in West Perth has declined since 2012, with currently no new stock under construction in the short to medium term.

Current office stock in West Perth is predominately older style office buildings with secondary grade assets accounting for 61% of the total availability. As tenants seek to upgrade to better quality office space, secondary assets may struggle to compete for new tenants and renewals of existing tenancies.

The main driver of development activity in the short to medium term, continues to be the refurbishment of secondary grade stock. For example, 66 Kings Park Road, West Perth is currently undergoing extensive refurbishment to include a new entry way, a café tenancy, full floor upgrades to include bathrooms, and end of trip facilities.

A potential new development within West Perth is located at the corner site of 957-959 Wellington Street. The development is to comprise a mixed-use project with four commercial tenancies totaling 1,414m². The project currently has development approval but is mooted, with completion due around late 2018-2019. However without a pre-commitment the development is unlikely to proceed.

West Perth is therefore unlikely to see any new significant development activity with soft market conditions causing a strain on project feasibility.

The overall stock for the West Perth office market was 424,061m² in July 2017 which is a marginal reduction on January 2017 at 426,355m².

The decrease in stock over the six month period is largely due to the refurbishment and withdrawal of office space in 66 Kings Park Road, West Perth.

Net Absorption & Vacancy

As at July 2017, West Perth has had its fourth year of negative net absorption since July 2013, according to the PCA. Although there have been improvements in net absorption in the six months to July 2017, recording a positive 8,666m^2 of net absorption. A-Grade office stock attributed to 64% of the net absorption in the six months to July 2017, demonstrating preference by tenants for quality A-Grade office space over secondary graded. It is expected it will take some time for the market to absorb the higher than historically recorded vacancy levels.

Tenants continue to take advantage of market conditions tipping in their favour, and are upgrading to better quality space, which have become more affordable due to the level of incentives being offered.

West Perth vacancy has recorded as low as 3.3% as at July 2012. Subsequently, the PCA has shown vacancy rates consistently trending upwards peaking at 17.5% in January 2017. As of July 2017, vacancy in West Perth has experienced its first decrease since January 2012, and stood at 15.0%, down from 17.5% in January 2017.

A-Grade vacancy currently totals 16,278m^2 (12.1%) a decrease from January 2017 total of 25,804m^2 (13.6%). Secondary office (combined B-Grade, C-Grade and D-Grade) vacancy also experienced a slight reduction, falling from 48,887 (17.0%) to 47,453 (16.4%). Secondary office space will continue to experience tough conditions as tenants are drawn to discounted effective rents in A-Grade office buildings.

Sub-lease space in West Perth has seen a significant reduction of 68% since January 2017, and stood at 4,875m^2 in July 2017. This accounted for 1.1% of total vacancy.

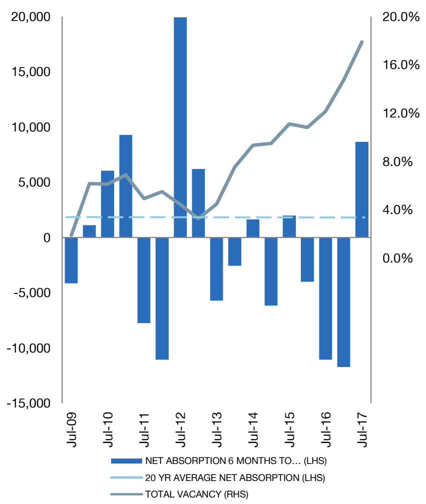
Rents & Incentives

Demand for office space in West Perth appears to be increasing, albeit tentatively, as vacancy levels decrease and the number of enquiries increase. The current economic environment is still offering prospective tenants the opportunity to consider relocating to better quality or upgraded accommodation. This is often at a lower rent than currently paying.

Since April 2017, average net face rents have held across both A-Grade and secondary grade office space. A-Grade net face rents range between \$350 to \$395/m^2 and secondary net face rents range between \$250 to \$295/m^2.

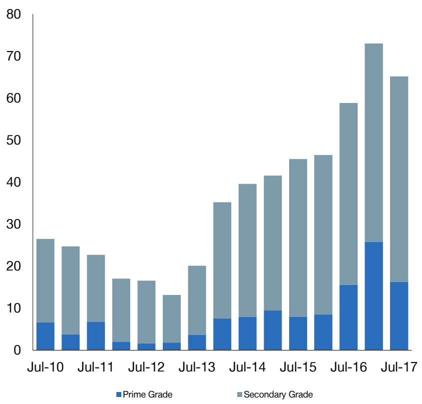
Although market sentiment is showing signs of improvement with incentive levels having firmed to around 30%,

FIGURE 1
Net Absorption and Vacancy
Per six month period (m^2 & %)



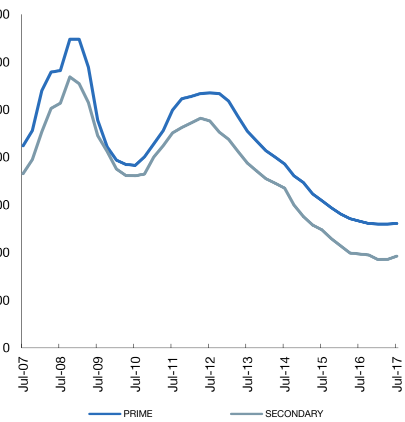
Source: Knight Frank Research, PCA

FIGURE 2
West Perth Vacancy Rates
A-Grade & Secondary Grade ('000 m^2)



Source: Knight Frank Research, PCA

FIGURE 3
Average Net Effective Rent
West Perth A-Grade & Secondary (\$/m^2)



Source: Knight Frank Research

TABLE 1
West Perth Office Market Indicators as at October 2017

Grade	Total Stock (m²)^	Vacancy Rate (%)^	Annual Net Absorption (m²)^	Annual Net Additions (m²)^	Average Net Face Rent (\$/m²)	Average Incentive (%)	Average Core Market Yield (%)
A-Grade	134,459	12.1	-4,671	-	350-395	30%	7.00—8.00
Secondary	289,602	16.4	1,607	1,706	250-295	30%	8.00—8.50
Total	**424,061**	**15.0**	**-3,064**	1,706			

Source: Knight Frank Research ^PCA data as at July 2017 tenants are still cautious with the result being shorter lease terms being committed, with 3-year lease terms now prominent. However this does also benefit the landlord as the shorter lease terms allows for a positive correction if the market recovers by expiry. Capital values are also impacted to a lesser degree, with the rebates and incentivised rental being spread across shorter terms.

TABLE 2

Recent Leasing Activity West Perth

Address	NLA	Term	Tenant	Lease	Date
15 Rheola Street	458	3	Finder Exploration	New	Sep-17
	340	3	Searcher Seismic	Renewal	Sep-17
1 Altona Street	349	3	Red Mountain	New	Aug-17
41 Colin Street	484	3	Sheffield Resources	Renewal	Jun-17
680 Murray Street	240	3	DCS Advisory Holdings	New	Jun-17
10 Ord Street	255	3	Battery Minerals	New	Jun-17

Source: Knight Frank Research

Investment Activity & Yields

Investment sales activity in West Perth has been limited, however the sale of the leasehold interest in 42-46 Colin Street represents a significant transaction, selling for $33.55 million in July 2017. This sold reflecting a 7.70% market yield and a passing yield of 9.30%

In the broader Suburban market recent transactions do offer some guidance to market yields expected in West Perth, with recent sales including 20 Parkland Road in Osborne Park and Hatch Building (144 Stirling Street, Perth) on the eastern periphery of Perth CBD all having settled in recent months. Analysed market yields on both of these assets were around 7.50%. Of note were the high passing returns of these transactions, with both sales displaying over 9% initial yields. Both assets were acquired by an interstate-based funds manager, attracted by the high passing return.

Similar to the broader investment market, investors are seeking long term WALEs that mitigate short term lease expiry and vacancy risk. The recent sale of the Leasehold tenure 42-46 Colin Street demonstrates the appetite for such assets when made available.

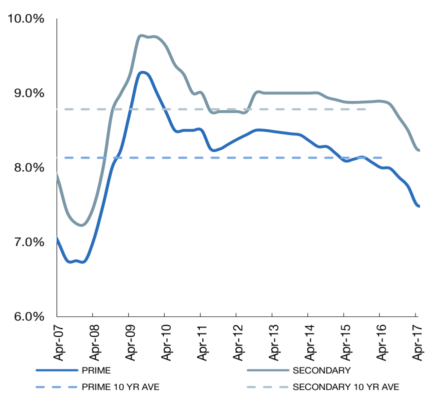
West Perth does provide counter-cyclical purchase opportunities, particularly for buildings requiring capital expenditure and refurbishment, as demonstrated by the recent sale of 66 Kings Park Road, now removed from the market and under refurbishment.

Market yields for A Grade West Perth assets would be considered to range between 7.00% and 8.00% depending on location, quality and lease terms. Secondary assets remain stable and range between 8.00% to 8.50%.

FIGURE 4

West Perth Office Yields

A-Grade and Secondary Core Market Yield



Source: Knight Frank Research

> "42-46 Colin Street indicates the investment market appetite for securely leased assets in West Perth"

TABLE 3

Recent Sales Activity West Perth and Suburban Office

Address	Grade	Price $ mill	Core Market Yield (%)	NLA m²	$/m² NLA	WALE (yrs)	Vendor	Purchaser	Sale Date
42-46 Colin St, West Perth	A	33.55	7.7	8,433	3,978	4.8	DEXUS CPAPty Ltd	Centuria Metropolitan	Jul-17
144 Stirling St, Perth	A	58.2	7.6	11,042	5,271	4	Charter Hall	Centuria Metropolitan	Jun-17
20 Parkland Rd, Osborne Pk	A	27.5	7.41	4,825	5,699	6	Decmil Properties	Primewest Funds LTD	May-17

Source: Knight Frank Research

Outlook

West Perth experienced strong demand over the past decade for office space, driven by the lift in commodity prices and a large increase in capital inflow directly related to the mining boom. However, more recently this has resulted in an oversupply which has yet to be absorbed.

Vacancy levels are indicating tentative signs of recovery, with incentives showing signs of stabilizing to 30% over the past six months. Vacancy levels should continue to improve in the short to medium as there is no new major supply forecasted.

Going forward, whilst face rentals are considered to show limited growth, as net incentives decrease, the impact on effective rentals will be positive.

Tenants will continue to enjoy the tenant favored market conditions, allowing them to take advantage of incentives on offer and alternate leasing options including relocation to a better location or better quality space.

Sales activity and investor sentiment has improved, with investors seeing the potential in purchasing B-Grade stock and undertaking a refurbishment.

It is likely the investor demand and sales activity will remain strong over the remainder of 2017, and into early 2018, for assets demonstrating strong investment fundamentals and mitigating short term vacancy risk.

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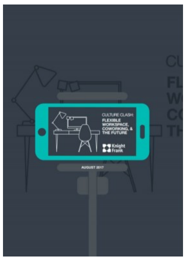

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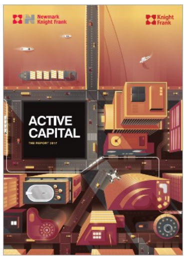

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