

WEST PERTH

OFFICE MARKET BRIEF MAY 2015

Key Facts

The West Perth vacancy rate increased to 10.9% from 9.2% recorded six months ago.

The West Perth office market recorded negative net absorption of $-6,359\text{m}^2$ over the past six months.

Incentive levels are expected to remain high, at an average of 30% of net rent.

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



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The West Perth office market recorded a marginal increase in net supply of 750m^2 over the past six months. In the same period of time, total sublease vacancy doubled from $3,565\text{m}^2$ to $7,502\text{m}^2$.

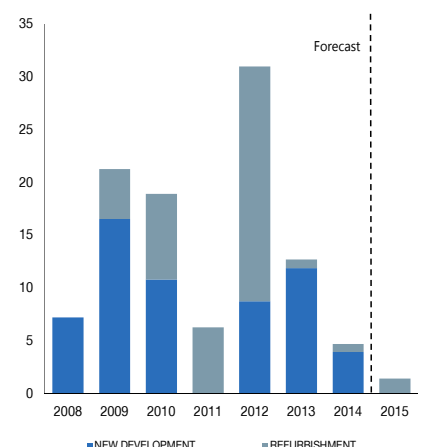
Development Activity

The West Perth office market recorded a marginal increase in net supply of 750m^2 in the six months to January 2015 bringing the total stock to $422,840\text{m}^2$ based on the latest data released by the Property Council of Australia (PCA). The addition in supply included a new development at 1160 Hay Street ($1,404\text{m}^2$) and a full refurbishment at 11-13 Lucknow Place (765m^2) which was completed in the third quarter of 2014. A total NLA of $1,419\text{m}^2$ from 1162 Hay Street was withdrawn from the stock count as the building is undergoing a full refurbishment.

In terms of future supply over the next six months, West Perth is only expecting the completion of refurbishment works at 1162 Hay Street adding $1,419\text{m}^2$ of NLA back to the office market stock count. The $1,414\text{m}^2$ of new office space slated at 957-959 Wellington Street is awaiting a development approval as at early 2015.

There is no other supply under construction or being refurbished that is due for completion in 2015 and beyond.

FIGURE 1
West Perth Office Supply
New and Refurbished Stock ($'000\text{m}^2$)



Source: Knight Frank/PCA

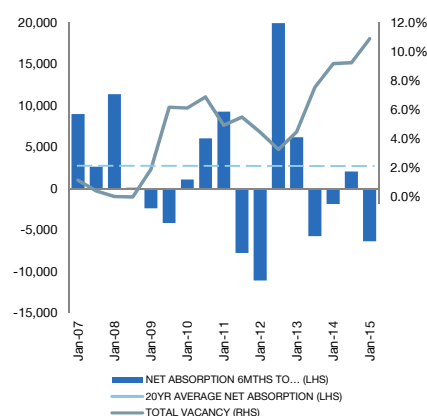
As a result of new incoming supply in the Perth CBD where approximately 149,600m² of office buildings is currently under construction and expected to be completed this year, new office developments in West Perth are highly unlikely in the short to medium term as the market will take time to absorb the new CBD supply. Nevertheless, current ageing stock in West Perth presents a good opportunity for refurbishment works in order to remain competitive in prevailing market conditions.

Net Absorption & Vacancy

January 2015 recorded a negative net absorption over the 12 month period at -4,310m². Over the year, absorption declined from positive 2,049m² in H1 2014 to negative 6,359m² in the second

FIGURE 2
West Perth Vacancy & Net Absorption

Per six month period (m²)



Source: Knight Frank/PCA

half, the highest negative net absorption since January 2012 (-11,065m²).

The West Perth office market also recorded a notable increase in sublease space available in the market as companies continue to downsize. The total sublease vacancy doubled from 3,565m² to 7,502m² over the past six months.

Secondary grade buildings recorded a significant decline in net absorption of -6,303m² from a positive 2,446m² recorded in H1 2014. Absorption in prime grade buildings totalled negative 56m² over the same period of time.

In line with negative absorption rates, vacancy rates increased by 1.7% from 9.2% in July 2014 to 10.9%. The prime grade vacancy totalled 9,430m² representing 6.8% of total prime stock with the direct vacancy accounting for the majority (786m² of sublease). The secondary grade vacancy totalled 36,687m² representing 12.9% of total secondary stock which was dominated by direct vacancy (29,971m²).

Falling rents have encouraged tenants to seek better quality accommodation which is demonstrated by vacancy being heavily skewed to the secondary market.

Tenant Demand & Rents

Similar to the Perth CBD market, tenant demand remains soft due to uncertainty in current economic conditions as well as businesses looking to improve cost efficiencies and consolidate their office accommodation. The latest PCA figures

show tenant demand was weakest in West Perth's secondary grade office market which recorded 36,687m² of vacant space, the highest in 20 years.

Tenants prefer to be more cautious adopting the 'wait-and-see' approach before committing to a lease. This is evident from the majority of office leases secured in West Perth in 2014 being short term leases (below 5 years) such as Ascend Corporate and Minespace which both recently signed 3-year leases at 1292 Hay Street, West Perth taking up a total NLA of 698m².

High vacancy levels have resulted in further downward pressure on West Perth office rents in both prime and secondary assets. Prime net face rents have softened to an average of \$462/m² (vs. \$501/m² in Apr-14). Secondary net face rents have also declined to \$368/m² (vs. \$432/m² in Apr-14) due to strong competition as leasing options become comparably cheaper. This is the lowest secondary-grade net face rent since July 2007. On an effective basis, rents have fallen by circa 20% over the past year, predominantly on the back of increasing incentive levels.

The increasing vacancy continues to add further pressure on landlords to accept rental levels in accordance with prevailing market conditions. As a result, tenants are benefitting from increasing incentives in the form of rent free periods and capital contributions for office fit-outs, which are minimising the costs associated with tenant relocation. Prime and secondary incentive levels have crept up and are expected to remain elevated at an average of 30% of the net rent.

TABLE 1
West Perth Office Market Indicators as at April 2015

Grade	Total Stock (m ²) [^]	Vacancy Rate (%) [^]	Annual Net Absorption (m ²) [^]	Annual Net Additions (m ²) [^]	Average Net Face Rent (\$/m ²)	Average Incentive (%)	Average Core Market Yield (%)
Prime	138,459	6.8	-453	1,404	462	30	7.75—8.25
Secondary	284,381	12.9	-3,857	1,890	368	30	8.50—9.25
Total	422,840	10.9	-4,310	3,294			

Source: Knight Frank [^] as at January 2015

Investment Activity & Yields

West Perth continued to experience soft investment market conditions in 2014 despite recording a marginal increase in office sales activity to \$42.65 million across three transactions, in comparison to 2013 where three office assets worth \$29.8 million changed hands. The three office buildings sold in 2014 included 16 Parliament Place for \$22.60 million in October 2014, 38-40 Ord Street for \$11 million in June 2014 and 1314 Hay Street for \$9.05 million in May 2014.

The West Perth office market has recorded no sales transactions during the first four months of 2015. However, it is reported that Perth-based fund manager, Primewest will be listing two West Perth office investments for sale at 619 Murray Street and 53 Ord Street as

TABLE 2

Recent Leasing Activity West Perth

Project	NLA m ²	Face Rent \$/m ²	Term yrs	Incentive (%)	Tenant	Date
1292 Hay Street	111	375 n	3	undis	Ascend Corp.	Jan-15
35 Outram Street	273	375 n	3.5	33	Estrat Pty Ltd	Nov-14
1292 Hay Street	587	415 n	3	undis	Minespace	Oct-14
111 Colin Street	596	350 n	2	10	undis	Sep-14
1160 Hay Street	261	545 n	6	12-17	Global Transport	Sep-14

Source: Knight Frank undis: Undisclosed n: Net

part of a \$250 million portfolio. These properties will provide some guide to the current investor sentiment in a market with relatively few transactions.

The last major transaction in West Perth was recorded in October 2014 where 16 Parliament Place was purchased by a private investor from Primewest for \$22.6 million making it the largest transaction of the year. The sale reflected an initial passing yield of 8.28% (core market yield 7.50%). The building with a net lettable area of 2,989m² is fully leased through to mid 2020 by two separate tenants namely WA Solicitors Pty Ltd and Dampier Port Authority. The property is located within the "Parliament House Precinct" and situated approximately 80m from Parliament House, 240m from Hay Street and positioned directly opposite Solidarity Park. The property sold with a WALE by income of 5.6 years, reflecting building rate of \$7,561/m².

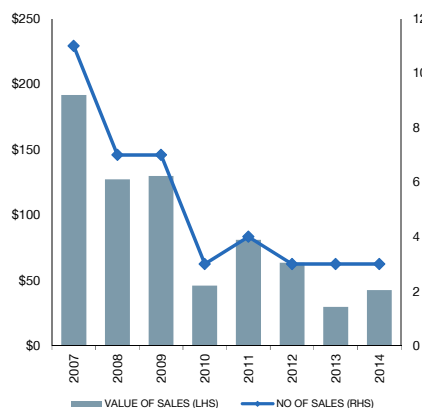
Prime yields continued to compress in 2014. This has been evident since January 2013 with a firming of 27bps recorded over the past year. Average

prime core market yields are currently estimated to range between 7.75% and 8.25%. Similarly, secondary market yields recorded a marginal firming by 12bps over the past year. Average secondary core market yields are estimated to range from 8.50% to 9.25%.

"No sales transactions were recorded during the first four months of 2015, however some major listings are imminent."

FIGURE 3

West Perth Sales Activity (\$ million) Sales Value > \$5 million



Source: Knight Frank

TABLE 3

Recent Sales Activity West Perth

Address	Grade	Price \$ mil	Core Market Yield (%)	NLA m ²	\$/m ² NLA	WALE (yrs)	Vendor	Purchaser	Sale Date
16 Parliament Place	B	22.60	7.50	2,989	7,561	5.6	Primewest	Private Investor	Oct-14
38 - 40 Ord Street [#]	B	11.00	6.80	1,580	6,962	0.3	Greenplace	MercyCare	Jun-14
1314 Hay Street	B	9.05	8.36	1,892	4,783	4.8	Private	Ascot Capital	May-14

Source: Knight Frank #: purchased for owner occupation



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Outlook

Tenant enquiry levels indicate net absorption will remain weak for the remainder of 2015. Nevertheless, falling rents and increasing incentives are providing tenants with some favourable leasing options which is expected to stimulate tenant migration to better quality premises. Going forward, West Perth prime rents may begin to stabilise but little to no improvement is expected before 2017 as the market absorbs the significant levels of supply forecast to come online in the Perth CBD.

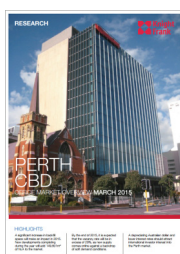
In terms of future supply over the next six months, there are no buildings under construction or being refurbished that are due for completion in 2015 and beyond. Knight Frank expects the vacancy to remain at around current levels through to 2017. Any reduction

thereafter will only come from improving demand conditions and a continued lack of new supply.

With domestic and offshore investors seeking to expand their presence in the Perth market, coupled with the low Australian dollar and high interest rates, it is anticipated that investment demand for West Perth office assets will improve with the majority of the buyer attention continuing to focus on securely leased prime assets. The limited number of sales is partly attributable to the tightly held nature of the market, with few properties being listed for sale.

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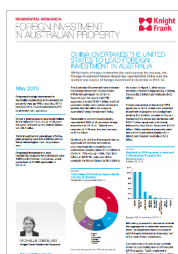
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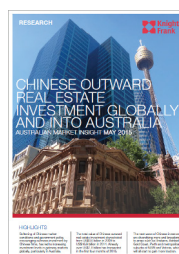
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