RESEARCH

# WEST PERTH
## OFFICE MARKET BRIEF APRIL 2016

## Key Facts

**The West Perth vacancy rate lifted to 12.2% as at January 2016** from 10.8% in July 2015.

**The office market recorded negative net absorption** of -4,010m$^2$ in the six months to January 2016.

**Incentive levels have risen in the last 12 months** to around 35%-40% of lease terms.

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


SONIA DISSANAIKE
**Research Analyst—WA**

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The West Perth office market is made up of aging stock, presenting opportunity for significant upgrades and value-add via major refurbishment works and repositioning in order to retain and attract tenants and create value.

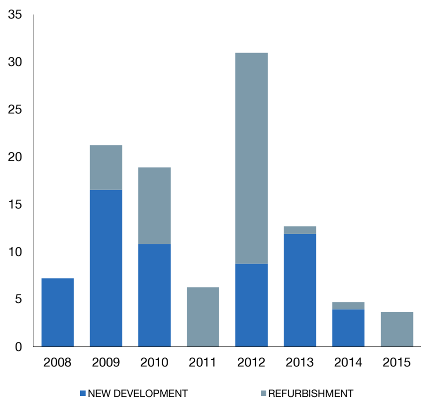
## Development Activity

The West Perth office market has experienced very little supply coming into the market. Since the peak in 2012, year on year office supply has declined with 2015 totalling 4,079m$^2$ of refurbishments reaching completion with no new developments in the pipeline. This refurbished stock includes a full refurbishment at 1162 Hay Street (1,865m$^2$), allowing for additional parking and internal improvements, and a partial refurbishment to 46 Ventnor Avenue, including a new lift service and lobby refit.

The only other development activity for West Perth is the mixed-use project that has Development Approval at 957-959 Wellington Street. This project is mooted for completion around 2018-2019 and is unlikely to go ahead without some pre-commitment achieved. The plans include an eight level mixed use development with four commercial tenancies accounting for 1,414m$^2$ of office space.

The overall stock for the West Perth office market is 425,555m$^2$, up 1,865m$^2$ in the six months to January 2016. As the Perth CBD office market absorbs new supply of circa 113,463m$^2$ it is expected that the

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




Source: Knight Frank Research/PCA

West Perth market is unlikely to develop any new office buildings in the short to medium term.

Suburban markets such as West Perth are unlikely to see development activity with soft market conditions causing a strain on project feasibility. It is likely that new projects will find it difficult to break ground in 2016. Refurbishing and repositioning of existing stock will be more likely going forward.

## Net Absorption & Vacancy

Net absorption continues to be volatile in the West Perth office market recording negative 4,010m$^2$ for the six months to January 2016 (-2.013m² for the year). The negative absorption is attributed to low demand and a lack of movement in these lower grade assets, leading to an increase in vacancy. The trend in the market is heavily skewed to tenants taking less space but still seizing the opportunity to move into better quality office accommodation. It is evident that the majority of negative absorption is in lower grade stock. Net absorption in B and C grade assets combined totalled –3,312m$^2$ for the six month period to January 2016.

The West Perth vacancy fell as low as 3.3% as at July 2012. Subsequently, vacancy rates have consistently trended upwards, with the current vacancy rate at 12.2%, totalling 51,745m$^2$ of space. This lift was driven by cumulative negative net absorption of –14,809m² over the past three years.

The overall vacancy increase recently has been driven by an influx of vacant secondary stock. The total vacancy increased by 5,875m$^2$ in West Perth over the six month period. Of this space, 89% is classified as secondary grade (4,673m$^2$). The Prime grade office vacancy totalled 6.1% up marginally from the previous six months. The Prime vacancy last peaked in January 2015 at 6.8%. Whereas Secondary grade vacancy increased from 13.5% to 15.1% over the six months to January 2016. This amounts to 43,232m² of vacant secondary office space currently in the market.

Sublease space on the market is low demonstrating that tenants are moving and reassessing their options, more specifically their space requirements. There was 6,526m$^2$ of space available as at January 2016, which is around 60% higher than the long term, 25 year average . Over the past six months the West Perth market recorded a 45% increase in sublease space, and now makes up 1.5% of the total vacancy.

## Tenant Demand & Rents

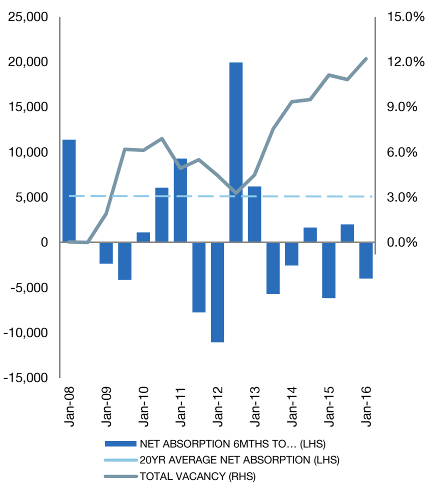
Leasing activity in West Perth slowed down over the second half of 2015. A continuation of soft demand in 2016 has resulted in further falls in rental levels. The current economic environment has allowed tenants the ability to consider relocating into larger office space or better located space as rents fall and incentives rise. High vacancy levels have added further pressure on landlords to accept rental levels much lower than those seen three years ago, when the vacancy was sitting at 4.5%.

Average Prime net face rents are currently sitting between \$380-\$410/m$^2$ as at April 2016, which is an annual drop of 14.7% (down 19.2% on an effective basis). Similarly, secondary net face rents have been on a downward

FIGURE 2

**West Perth Vacancy & Net Absorption**

Per six month period (m$^2$)

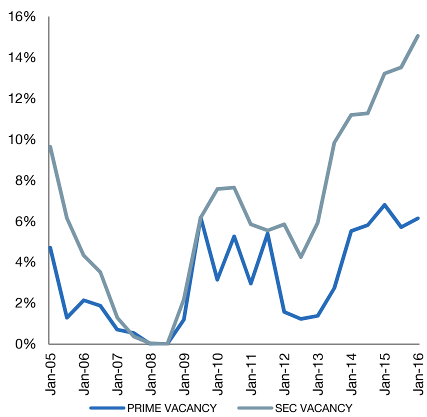



**Source:** Knight Frank Research/PCA

FIGURE 3

**West Perth Prime & Secondary Vacancy Rates**

Per six month period (%)




**Source:** Knight Frank Research/PCA

TABLE 1

**West Perth Office Market Indicators as at April 2016**

| 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 (%) |
|---|---|---|---|---|---|---|---|
| Prime | 138,459 | 6.1 | 917 | 0 | 380-410 | 35-40 | 7.75—8.25 |
| Secondary | 287,096 | 15.1 | -2,930 | 2,715 | 290-320 | 35-40 | 8.50—9.25 |
| **Total** | **425,555** | **12.2** | **-2,013** | **2,715** | | | |

**Source:** Knight Frank Research ^PCA data as at January 2016 trend since April 2012 ($508/m$^2$) and are currently averaging $290-$320/m$^2$ as at April 2016, an annual fall of 17.4% (down 20.5% on an effective basis).

This fall is due to strong competition as leasing options become comparably cheaper in West Perth and the CBD. As a result, tenants are benefitting from increasing incentives in the form of rent free periods and capital contributions for office fit outs which, in turn, minimise the costs associated with tenant relocation. It is expected that the increase in vacancy in B grade stock will keep incentives above the 30% mark to attract tenants.

In this market, tenants are adopting a more cautious approach before committing to a lease. This is apparent when looking at the fall in rents and shorter lease terms within contracts. Leases secured in the last 6-12 months have generally been for terms of one to three years. Falling rents have encouraged tenants to seek better quality office space which is demonstrated by the vacancy being heavily skewed to the secondary market as tenants vacate their lower grade locations.

TABLE 2

**Recent Leasing Activity West Perth**

| Address | NLA m² | Term yrs | Tenant | Lease Type | Date |
|---|---|---|---|---|---|
| 35 Outram Street | 269 | 5 | HBL Insolvency | New | Feb-16 |
| | 153.5 | 3 | Greenwich & Co Pty Ltd | Renew | |
| 28 Kings Park Road | 203 | 2 | Energy Metals | New | Apr-16 |
| | | | AMOG | Renew | Nov-15 |
| 12-14 Thelma Street | 203 | 1 | Doowlap Pty Ltd | Renew | Nov-15 |
| | | | Kingrose Mining | | |

Source: Knight Frank Research

## Investment Activity & Yields

Investment sales activity in West Perth has remained somewhat subdued over the past 12 months. The lack of quality stock combined with the uncertain economic conditions has had some affect on transaction activity in recent times.

The only transactions that occurred in 2015 were finalised in the second half of the year with 53 Ord Street selling for $59 million in August 2015 to a Singaporean group, Mapletree Investments. The five level A Grade office building is occupied by ConocoPhillips and includes 6,864m$^2$ of NLA with a lease expiry in 2022. The core market yield was 7.4%.

The most recent transaction for West Perth occurred in November 2015, at 4 Ord Street which sold for $8,875,000. The three level B grade office building has a NLA of 2,079m$^2$. The core market yield was 8.73%.

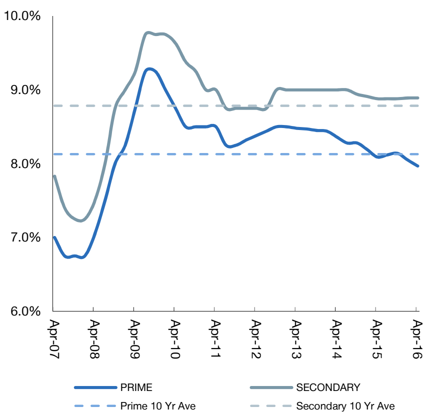
Market yields for A grade assets located in West Perth have tightened in the six months to April 2016 and are estimated to range between 7.75% and 8.25%. Secondary grade assets have been more or less stable, averaging between 8.50% and 9.25%. The forecast is that yields will remain at around current rates in 2016, with little to no firming expected.

“Investment sales activity has remained somewhat subdued over the past 12 months.”

FIGURE 4

**West Perth Prime & Secondary Yield**

Quarterly with long term average




Source: Knight Frank Research

TABLE 3

**Recent Sales Activity West Perth**

| Address | Grade | Price $ mil | Core Market Yield (%) | NLA m² | $/m² NLA | WALE (yrs) | Vendor | Purchaser | Sale Date |
|---|---|---|---|---|---|---|---|---|---|
| 3 Ord Street | B | 8.875 | 8.73 | 2,079 | 4,269 | 3.4 | Len Buckeridge Estate | Stirling Capital | Nov-15 |
| 53 Ord Street | A | 59.00 | 7.40 | 6,864 | 8,596 | 7.4 | Primewest | Mapletree Investments | Aug-15 |

Source: Knight Frank Research


## Outlook

The demand for office space over the past decade was driven by a strong lift in commodity prices and the large increase in capital inflow directly related to the mining boom. This in turn led to an over supply which is yet to be absorbed and competition for tenants is growing.

Tenant enquiry levels indicate net absorption will remain weak during 2016. Nevertheless, falling rents and increasing incentives are providing tenants with alternate leasing options including relocation to better locations or better quality space.

Increased levels of vacancy will lead to challenging market conditions in West Perth across 2016. Rents have continued to be driven lower by the increase in vacant stock and lack of demand. There is a ripple effect from the Perth CBD office market being impacted by the downturn in the resource sector which is flowing through to West Perth and other office markets surrounding the CBD.

Transactions have decreased in recent times with only two sales occurring in West Perth over the last 12 months. The lack of quality stock with medium to long term WALE's, combined with uncertain economic conditions has affected transaction activity.

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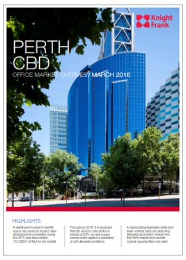


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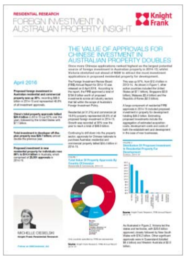
Australian Residential Review April 2016



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**RESEARCH**
**Sonia Dissanaike**
Research Analyst — WA
+61 8 9225 2412
Sonia.Dissanaike@au.knightfrank.com

**Matt Whitby—Sydney, NSW**
Group Director, Head of Research & Consulting
+61 2 9036 6616
Matt.Whitby@au.knightfrank.com

**PERTH**
**Craig Dawson**
Managing Director – WA
+61 8 9225 2406
Craig.Dawson@au.knightfrank.com

**CAPITAL MARKETS**
**Todd Schaffer**
Senior Director — Commercial Sales WA
+61 8 9225 2402
Todd.Schaffer@au.knightfrank.com

**Tony Delich**
Director — Commercial Sales WA
+61 8 9225 2528
Tony.Delich@au.knightfrank.com

**OFFICE LEASING**
**Greg McAlpine**
Senior Director, Head of Division – WA
+61 8 9225 2426
Greg.McAlpine@au.knightfrank.com

**Ian Edwards**
Senior Director — Office Leasing & Asset Management Services
+61 8 9225 2420
Ian.Edwards@au.knightfrank.com

**Sallese Wilmot-Barr**
Associate Director — Office Leasing
+61 8 9225 2405
Sallese.Wilmot-Barr@au.knightfrank.com

**Dan Clarke**
Leasing Executive—Office Leasing
+61 8 9225 2434
Dan.Clarke@au.knightfrank.com

**GLOBAL CORPORATE SERVICES**
**Bret Madden**
Director, Head of Division
+61 8 9225 2407
Bret.Madden@au.knightfrank.com

**VALUATIONS**
**Marc Crowe**
Senior Director, Head of Division – WA
+61 8 9225 2521
Marc.Crowe@au.knightfrank.com

**ASSET MANAGEMENT SERVICES**
**Ryan Abbott**
Senior Director, Head of Division — WA
+61 8 9225 2416
Ryan.Abbott@au.knightfrank.com

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