RESEARCH

Knight Frank

WEST PERTH

OFFICE MARKET BRIEF OCTOBER 2016

The West Perth office market is made up of ageing 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.

Key Facts

The West Perth vacancy rate lifted to 14.8% as at July 2016 from 12.2% in January 2016.

The office market recorded negative net absorption of -11,061m^2 in the six months to July 2016.

Incentive levels have stabalised to around 35%-40% of lease terms.

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

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Development Activity

Since the peak in 2012, year on year development activity in the western fringe market has declined. There has been very little new supply entering the market. Moving forward, in the short to medium term, there remains very little stock under construction in West Perth. A high proportion of the office stock in West Perth is of an older build making it less desirable in this market. It does provide the opportunity for owners to refurbish or redevelop the existing stock in order to add value. Currently there are a number of existing tenancies that are undergoing upgrades to internal fitout and this trend is likely to continue.

There is one potential project in the works within West Perth, located at 957-959 Wellington Street. The mixed-use project has Development Approval but is mooted for completion around 2018-2019 and is unlikely to go ahead without some pre-commitment achieved. The plans for the 1,414m^2 of office space include an eight level mixed use development with four commercial tenancies.

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 2017. Refurbishing and repositioning of existing stock will be more likely going forward.

The overall stock for the West Perth office market is 425,555m^2, unchanged from the previous six months to January 2016. As the Perth CBD office market absorbs new supply of circa 113,463m^2 it is expected that the West Perth market is unlikely to develop any new office buildings in the short to medium term.

Net Absorption & Vacancy

Net absorption continues to be volatile in the West Perth office market. The last positive six month period was July 2015 where the West Perth market totalled 1,997m^2 and is currently recording negative 11,061m^2 for the six months to July 2016 (-15,071m² for the year). Thus it is necessary to allow some time for the market to absorb the higher than historical vacancy levels.

The trend in the market is tenants taking less space but still seizing the opportunity to move into better quality office accommodation. 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 14.8%, amounting to 62,806m^2 of office space. This was a lift from the previous six months of 11,061m^2 vacant and was driven by cumulative negative net absorption of –19,233m² over the past two years. Of this vacant space, 75% is classified as secondary grade (47,199m^2).

The Prime grade office vacancy totalled 15,607m^2 (11.3%) up from the previous six months figure by 7,094m^2. Secondary grade vacancy increased from 15.1% to 16.4% over the six months to July 2016. This amounts to 47,199m² of vacant secondary office space currently in the market. There is a much larger portion of secondary grade office space in West Perth than prime, (see Figure 2) which will prove difficult to lease in the short term.

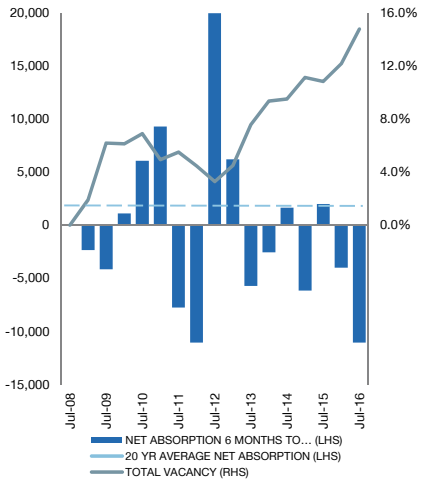
The level of sublease space available in the market is still proportionately low in comparison to the CBD. There was 12,242m^2 of space available as at July, 2016, which has lifted since last years figure of 6,526m^2. Over the past six months the West Perth market recorded an increase in sublease space which now makes up 2.9% of the total vacancy. This is attributed to occupiers moving or giving back space to then accommodate a smaller footprint. This was highlighted in the SLS Accounting deal, where the firm negotiated a new lease at 35 Ventnor Avenue for 361.5m^2, relocating from their previous accommodation at 50 Colin Street of 397.5m^2.

Rents & Incentives

A continuation of soft demand in the West Perth office market 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 four years ago, when the vacancy rate was only 3.3%.

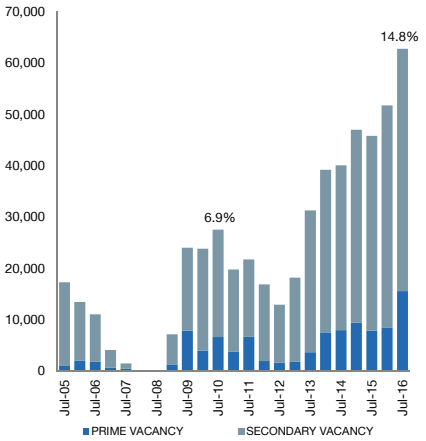
Average Prime net face rents are between $370-$410/m^2 as at October

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



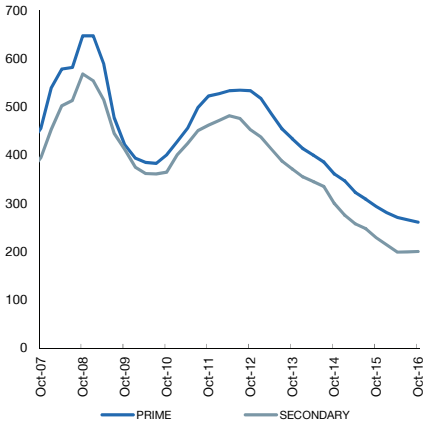
Source: Knight Frank Research/PCA

FIGURE 2
West Perth Vacancy Rates
Prime and Secondary Grade (sqm)



Source: Knight Frank Research/PCA

FIGURE 3
Average Net Effective Rent
West Perth Prime & Secondary Office ($/sqm)



Source: Knight Frank Research

TABLE 1
West Perth Office Market Indicators as at October 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	11.3	-7,696	0	370-410	35-40	7.50—8.50
Secondary	287,096	16.4	-7,375	1,865	280-315	35-40	8.25—9.25
Total	**425,555**	**14.8**	**-15,071**	**1,865**			

Source: Knight Frank Research ^PCA data as at July 2016

2016, which is an annual drop of 13.5% (down 15.5% on an effective basis). Similarly, secondary net face rents have been on a downward trend since April 2012 ($508/m^2) and are currently averaging $295/m^2, an annual fall of 16.4% (down 19.0% on an effective basis).

Incentives have been on the rise in the West Perth office market since late 2013 and have now appeared to stabilise at 35-40%. As a result, tenants are benefitting from increased 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. Across the board the rental market has seen net rents remain more or less stable with the impact of a greater incentive, being a percentage of the first years annual rent across the term. This has given tenants a saving on their total accommodation cost over the term of their lease.

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

> "Investment sales activity has remained somewhat subdued over the past 12 months."

TABLE 2
Recent Leasing Activity West Perth

Address	NLA m²	Term yrs	Tenant	Lease Type	Date
28 Kings Park Road	462	3	Optika Solutions	New	Jun-16
	203	2	Energy Metals		Apr-16
44A Kings Park Road	178	4	Leaker Partners	New	Jun-16
33 Richardson Street	140	4.1	Citadel Magnus	New	Jun-16
440 Hay Street	439	5	Alyka	New	May-16
35 Ventnor Avenue	361	5	SLS Accounting	New	Apr-16
35 Outram Street	147	5	Kimberley Metals Group	Renew	Feb-16
	153	3	Greenwich & Co	Renew	

Source: Knight Frank Research

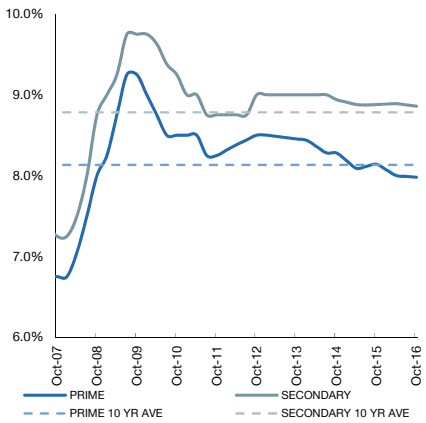
Investment Activity & Yields

Investment sales activity in West Perth has remained somewhat subdued over the past 12 to 24 months. The lack of quality stock combined with the uncertain economic conditions has had an affect on recent transaction activity.

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 and 3 Ord Street which sold for $8.875 million. Early 2016 saw the sale of 83 Havelock Street for $4.5 million to Wagoona Group Pty Ltd who also own the three adjoining properties at 85, 87 and 91 Havelock Street.

Market yields for A grade assets located in West Perth have tightened by 13 percentage points, averaging just under 8.0% in the six months to July 2016. Secondary grade assets have been more or less stable, averaging between 8.25% and 9.25%. The forecast is that yields will remain close to current levels in 2016, through to 2017, with little to no change expected.

FIGURE 4
West Perth Office Yields
Prime and Secondary Core Market Yield



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
83 Havelock Street	B	4.50	7.90*	1,293	3,480	1.0	Private	Wagoona Group Pty Ltd	Feb-16
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 *passing yield

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 with activity in the sub-1,000m^2 market the most buoyant.

Rents have continued to be driven lower by the increase in vacant stock and lack of demand. Falling rents and increasing incentives are providing tenants with alternate leasing options including relocation to better locations or better quality space. The West Perth vacancy levels will stabilize within the 13%-15% range in the short term. 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.

Sales transactions have decreased within West Perth over the last 12 months. The lack of quality stock with medium to long term WALEs, combined with uncertain economic conditions has affected transaction activity. It is likely the market will see a pick up in activity from private investors, over the next 12 months.

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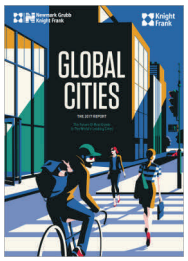

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