RESEARCH

WEST PERTH

OFFICE MARKET BRIEF MAY 2017

Key Facts

The West Perth vacancy rate lifted to 17.9% as at January 2017 from 14.8% in July 2016.

The office market recorded negative net absorption of -12,731m^2 in the six months to January 2017.

Incentive levels have stabilised averaging 30% - 35% of lease terms.

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

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Soft market conditions continue to constrain new development projects in West Perth, high quality space is being produced through refurbishment to compete for tenants in the 'flight to quality' trend.

Development Activity

New supply in West Perth has been declining since the peak in 2012. In the short to medium term, there remains very little stock under construction in West Perth.

Existing office stock in West Perth is mainly older style office buildings, making it less appealing in this 'flight to quality' market. The opportunity for owners to refurbish and redevelop their existing stock to attract tenants exists and is expected to be the main driver of development activity in the short term. Currently there are a number of existing tenancies that are undergoing internal upgrades to fit outs and this trend is expected to continue throughout the remainder of 2017.

A potential new development project within West Perth is located at 957-959 Wellington Street. The mixed-use project has Development Approval and is mooted for completion around 2018-2019. However, this is unlikely to proceed without a pre-commitment. The plans include for four commercial tenancies totaling 1,414m^2.

Suburban markets such as West Perth are unlikely to see significant 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. The overall stock for the West Perth office market is 426,355m^2, a marginal increase of 800m^2 since July 2016. As the Perth CBD office market is struggling to absorb the current vacancy of circa 397,000m^2, new development in West Perth is unlikely in the short to medium term.

Net Absorption & Vacancy

According to PCA data January 2017, West Perth has had its seventh consecutive recording of negative net absorption since January 2014 and is currently recording negative 12,731m^2 for the six months to January 2017 (-23,792m^2 for the year). It is expected that it will take some time for the market to absorb the higher than historical vacancy levels. The flight to quality trend occurring in both the West Perth and Perth CBD office markets, is allowing tenants to move into better quality space which has become more affordable due to falling rents and attractive incentives.

The West Perth vacancy fell as low as 3.3% as at July 2012. Subsequently, PCA data has shown that vacancy rates have consistently trended upwards, with the current vacancy rate at 17.9% (up from 14.8% as at July 2016), amounting to 76,337m^2 of office space, which is the highest amount of vacancy seen in West Perth to date.

Since July 2016, there has been an increase in tenants relocating from West Perth which has contributed to the negative net absorption. A Grade office vacancy totals 25,804m^2 (18.6%) of the A Grade stock, up from the July 2016 figure by 10,197m^2 (11.3%).

Secondary Grade vacancy increased from 16.4% to 17.5% over the six months to January 2017. This amounts to 50,533m² of vacant secondary office space currently in the market (up from the previous six months figure by 3,334m^2). The large amount of available stock in the Secondary Grade will continue to weigh on the market.

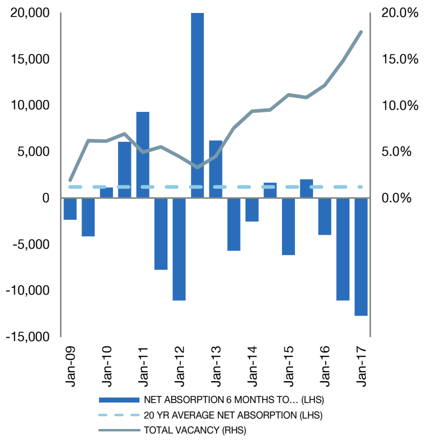
The level of sublease space available in West Perth, which, whilst increasing since July 2016, is still proportionately low in comparison to the CBD. There was 15,067m^2 of space available as at January 2017, which has lifted since the July 2016 figure of 12,242m^2. Over the past six months the West Perth market recorded an increase in sublease space which now makes up 3.5% (30 basis points less than the Perth CBD) of the total vacancy. This is attributed to occupiers moving or contracting to then accommodate a smaller footprint.

Rents & Incentives

Demand for office space in the West Perth market continues to be soft, although enquiry levels are increasing. The current economic environment does present opportunities for tenants to consider relocating to better quality or upgraded accommodation, often at rental levels below what they presently pay.

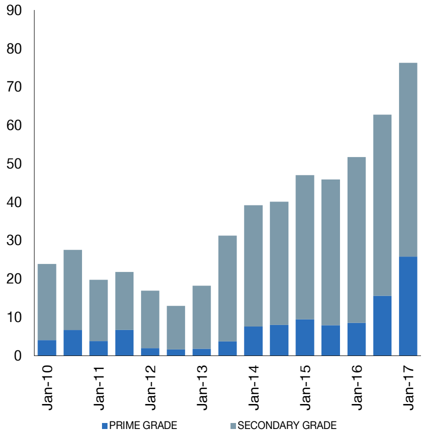
With the high vacancy levels, the pressure to reduce rental levels, initially resisted by landlords, has now been accepted across the West Perth market, with landlords competing with a large

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



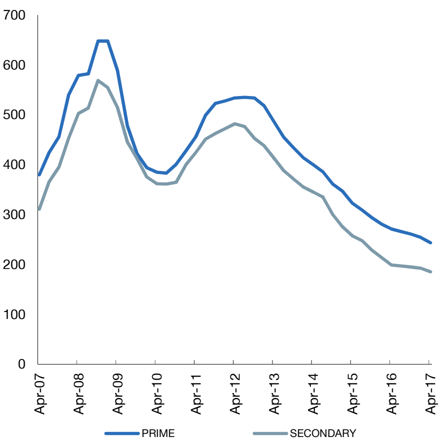
Source: Knight Frank Research/PCA

FIGURE 2
West Perth Vacancy Rates
A Grade and Secondary Grade ('000 sqm)



Source: Knight Frank Research/PCA

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



Source: Knight Frank Research

TABLE 1
West Perth Office Market Indicators as at April 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	138,459	18.6	-17,291	-	350-395	30-35	7.00—8.00
Secondary Grade	287,896	17.5	-6,501	2,665	250-295	30-35	8.00—8.50
Total	**426,355**	**17.9**	**-23,792**	**2,665**			

Source: Knight Frank Research ^PCA data as at January 2017 pool of competitors to retain or attract tenants to their buildings.

Average A Grade net face rents are between $\$350\text{-}\$395/m^2$ as at April 2017, which is an annual fall of 11.30% (down 13.9% on an effective basis) although they have been around this range for the past 6 months. Secondary net face rents have been on a downward trend since April 2012 ($\$508/m^2$) and are currently $\$250\text{—}\$295/m^2$ (and have been for the past 6 months)' an annual fall of -6.7% (down 10.2% on an effective basis).

Incentives have stabilised for A Grade and Secondary Grade buildings in West Perth and average around 30% - 35% for new tenants. Tenants continue to seek rent free periods, capital contributions and rental rebates.

The low face rents and incentives have put downward pressure on the effective net rent. This has afforded tenants a saving on their total accommodation costs over the terms of their lease and continues to play a large part in their likelihood to relocate.

Tenants are approaching leases with caution before committing in this market, as seen in the low levels of effective rents and shorter lease terms committed.

> The West Perth office market saw 4 transactions in the six months to January 2017 to the value of $46 million.

TABLE 2

Recent Leasing Activity West Perth

Address	NLA m^2	Term yrs	Tenant	Lease Type	Date
1 Campbell Street	401	2.5	National Advisor Services	New	Mar-17
	962	2.5	RAC Distribution	New	Mar-17
41—47 Colin Street	132	2	Nexus Minerals	Renew	Mar-17
44a Kings Park Road	158	5	Ashanti Capital	New	Mar-17
	125	4	Bailiwick Legal	Renew	Feb-17
18-32 Parliament Pl	1,853	2.6	MW Group	Renew	Feb-17
600 Murray Street	554	1	MSP Engineering	New	Feb-17

Source: Knight Frank Research

This situation does also favour landlords, with shorter lease terms allowing for a correction if the market recovers by lease expiry.

Investment Activity & Yields

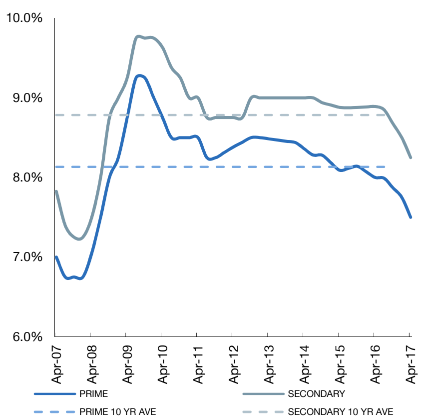
Investment sales activity in West Perth has been fairly limited, albeit there have been four transactions amounting to $46 million in sales that have occurred since July 2016. By sales volume, this is up from the year end 2015 which saw only two transactions, however the 2015 sales totaled $67.875 million for the calendar year, predominately from the $59 million sale of 53 Ord Street.

Notable recent sales include 1 West Street, a modern 2008-constructed 6 level office building, sold with vacant possession for $21 million. The State School Teachers Union purchased this property to owner occupy. 668 Murray Street, a recently refurbished modern four storey office building sold for $6.8 million to a private purchaser. Market yields for A Grade assets located in West Perth are considered to have tightened since July 2016, and now range between 7.00% – 8.00% depending on location, quality and lease terms. Secondary assets have also tightened to now range between 8.00% to 8.50%.

FIGURE 4

West Perth Office Yields

A Grade and Secondary Core Market Yield



Source: Knight Frank Research

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
66 Kings Park Road	B	16.1	7.90	4,698	3,427	0.2	Kings Park Road	Warrington Property	Jan-17
668 Murray Street	B	6.8	7.05	1,207	5,691	3.1	Private Seller	Private	Jan-17
1 West Street	A	21.0	-	3,935	5,336	VP	Demol Investments	SSTUWA*	Nov-16

Source: Knight Frank Research *State School Teachers' Union of WA

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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. Tenant enquiry levels have increased in the past 6 months, however net absorption will still remain weak during 2017 with activity in the sub-500m^2 market the most buoyant.

Effective rents and incentives have stabilised over the past 6 months and the rental market may be seen to have bottomed out. This is reflected in investor sentiment as the last six months have seen the most sales transactions occur since 2011. Face rents and incentives are expected to remain stable going forward.

Tenants will therefore continue to enjoy favourable market conditions, allowing them to take advantage of high incentives and alternate leasing options including relocation to a better location or better quality space. It is expected that vacancy levels will stabilise as no new major supply is expected for the short to medium term.

Sales activity has improved over the last 12 months resulting in a firming of the average A Grade yield by 50 basis points. Investors are seeing potential in purchasing B grade stock and refurbishing. It is likely the investor demand and sales activity will remain strong over the course of 2017.

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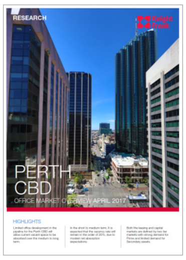

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