Perth CBD Office Market

April 2024

Perth continues to outperform the major capital city office markets of Sydney and Melbourne with strong rental growth and declining vacancy.

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Key Insights

A re-cut by PCA of Perth CBD's boundaries removed several major assets and created significant negative net-absorption. However, total vacancy still reduced.

Dr. Theo Connell-Variy
Associate Director, Research and Consulting

14.9%
Total Vacancy falling

Total vacancy decreased from 15.7% in January 2023 to 14.9% in January 2024, due to sustained demand and a significant quantum of stock withdrawals.

17,601
Sqm prime net absorption

Total net absorption was negative in 2023 due to PCA boundary re-cuts. Encouragingly, the prime market experienced positive absorption of 17,601 sqm for the 12 months to January 2024.

142,973
New supply 2024-2027

There are several schemes under construction for delivery during 2024, (including refurbishments of existing assets) and another injection of space mid-2025. A major completion in 2027 extends the period of sustained supply.

6.8%
Prime rent growth

Sustained demand and a tight market for premium-grade assets has caused prime net face rents to grow by 6.8% over the year.

46.3%
Prime incentives dropping

The average prime incentive dropped down to 46.3% in Q4 2023, supporting effective rental performance on top of rising face rents.

0.5%
Sub-lease vacancy

Sub-lease vacancy in the Perth office market remains stable at 0.5%. One of the lowest figures nationally, and considerably lower than Sydney and Melbourne markets.

Perth CBD Office Market Indicators – 1 January 2024

Grade	Total Stock sqm	Vacancy Rate %	Annual Net Absorption sqm	Annual Net Additions sqm	Av Net Face Rent $/sqm	Incentive %	Net Effective Rent Gth % y/y	Core Market Yield %*
Prime	1,082,749	12.7%	17,601	15,347	713	46.3%	12.0%	7.00
Secondary	642,014	18.5%	-72,682	9,068	435	51.0%	9.1%	8.13
Total	1,724,763	14.9%	-55,081	24,415				

Source: Knight Frank Research/PCA * assuming WALE 5 years

Prime product continues to dominate

NET ABSORPTION GOES NEGATIVE – BUT CAUSED BY CBD BOUNDARY REVIEW

Net absorption for the year to January 2024 totalled -55,081 sqm, interrupting what had been a sustained run of positive net absorption since 2021. However, the market has still performed better than the major CBD markets of Sydney and Melbourne where annual net absorption was deeper into negative territory during 2023.

The weakness in net absorption was related to a PCA boundary change which resulted in the withdrawal of eight significant assets, four of which were over 10,000 sqm. These were predominantly B and C-grade. Knight Frank believe that if the boundaries had remained the same as the preceding period there would have been approximately 20,000 sqm of positive net absorption.

QUALITY HOLDS OUT AS DEMAND FOR PREMIUM REMAINS POSITIVE

The net absorption figure for prime stock was strongly positive at 23,267 sqm over the past 12 months, reinforcing the ongoing flight to quality and strong demand for high quality product, supported by the addition of 177,473 sqm of new supply over the past three years.

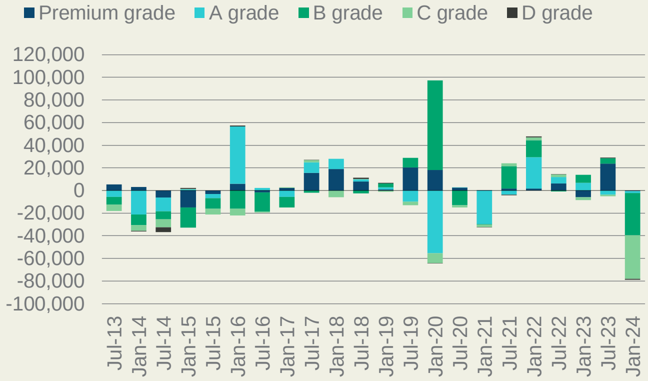
The strength of the prime market has partly offset the negative absorption caused by boundary recalibration, with secondary absorption falling by -72,682 sqm over the past 12 months, linked to the B and C-grade withdrawals.

ROBUST OFFICE DEMAND AIDED BY AN OUT-PERFORMING WA ECONOMY

Robust office demand comes on the back of a strong WA economy, which is out-stripping the performance of the Eastern states. Western Australia is the fastest growing state in Australia on a number of different metrics, with the fastest population growth of 3.3% in the year to September 2023 and the strongest growth in state final demand during 2023, recording 4.7% growth, well ahead of next best Queensland with growth of 2.4%.

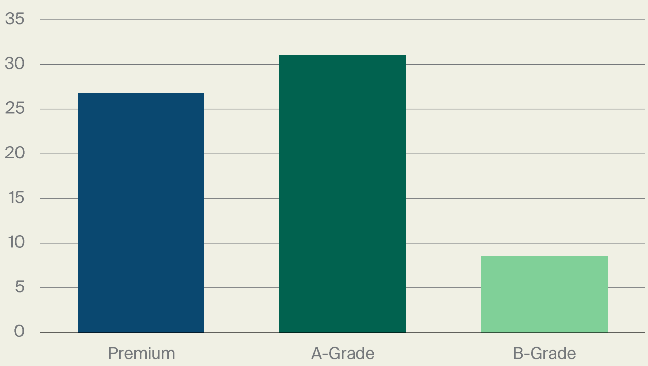
Forecasts point to continued strong growth in WA, underpinned by commodity industries and an extensive infrastructure and construction pipeline. This suggests that office demand will continue to come through and support positive net absorption, particularly for prime stock.

Net absorption
by grade, total sqm



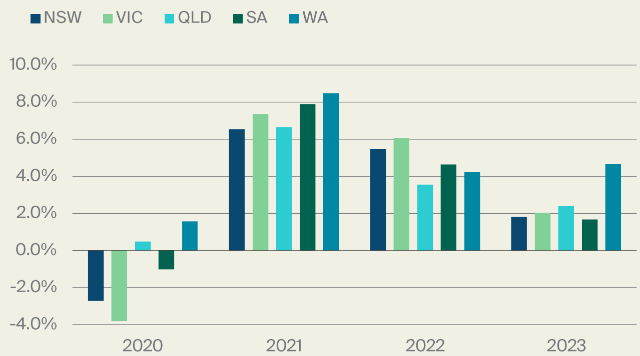
Source: Knight Frank Research, PCA

Perth CBD total absorption (2021-2023)
by building grade, 000's sqm



Source: Knight Frank Research

WA economy led the way in 2023
Annual growth in state final demand



Source: Knight Frank Research, ABS

Vacancy decline buoys sentiment

VACANCY DECLINE DEFIES A STRONG PIPELINE

Total vacancy decreased to 14.9% in January 2024, down from 15.7% a year ago. Within this, sub-lease vacancy remains low at 0.5%, second only to Brisbane nationally (0.4%). Vacancy has now fallen substantially from the recent peak of 19.9% in January 2021, thanks to sustained high demand, despite there having been a strong pipeline of new supply in the last few years.

The premium market is clearly the tightest with vacancy of just 7.8%, supporting strong rental growth. A-grade vacancy has fallen over the past year, down 0.6% to 16.1% as at January 2024, and well below the peak of 20.1% in early 2021.

Vacancy in secondary grade stock remains significantly higher at 18.5%, but this also reflected a decline, aided by the boundary realignment which saw withdrawals jump markedly to 139,603 sqm in the second half of the year. The withdrawals were predominantly of secondary stock, with B grade stock reducing by 58,405 sqm and C-grade stock by 51,571 sqm.

PIPELINE FOCUSED IN CORE

Some major completions are forecast in 2024, 2025 and 2027, being respectively, 1 Spring Street (13,681 sqm), 9 The Esplanade (32,000 sqm) and Lot 4 Elizabeth Quay (69,000 sqm). This will add 114,681 sqm of new space to the market, concentrating available stock between Elizabeth Quay and St Georges Terrace. Pre-commitment levels on these developments will provide a barometer for the strength of demand moving forward and may influence the timing of two mooted developments in the pipeline totaling 38,852 sqm.

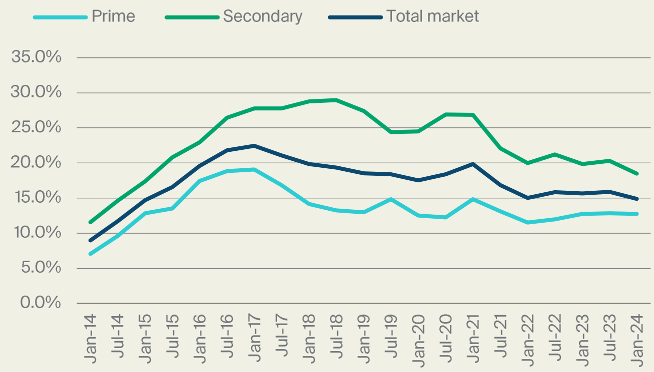
Developers are responding to an increasingly clear bifurcation in demand for prime and secondary assets, and with this in mind are focusing on green credentials and employee wellbeing in their development of premium assets.

Alongside the new developments, major refurbishments of key assets like QV1 and 186 St Georges Terrace will add over 25,000 sqm of quality space to the market as tenants continue to jostle for the best.

VACANCY TO NUDGE OUT IN THE MEDIUM TERM

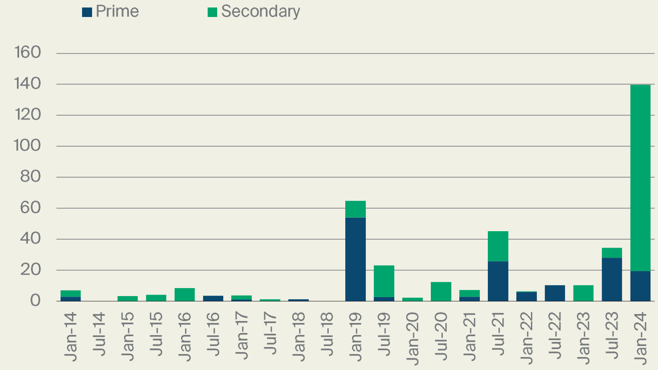
The new schemes mean that there is a solid supply pipeline in the short to medium term and this may see vacancy edge up slightly in coming years, depending on the pace of absorption. However, meeting feasibility thresholds has become more challenging in the face of higher construction costs and we expect the pipeline to be limited in 2027-28, which will lower supply once again keeping vacancy broadly stable over the forecast period.

Perth CBD Vacancy
by grade, %



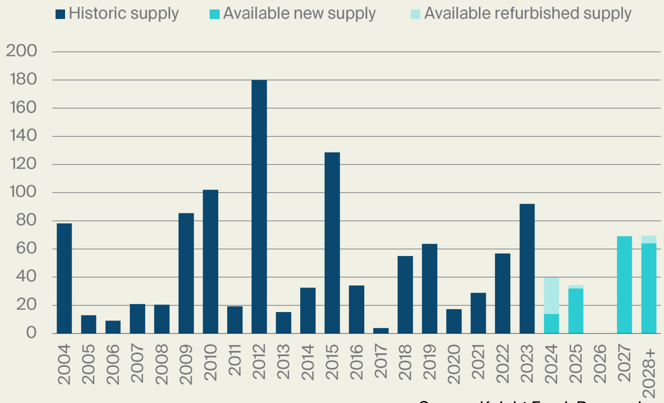
Source: Knight Frank Research, PCA

Perth CBD withdrawals
by grade, sqm



Source: Knight Frank Research

Perth CBD development pipeline
by commitment type, 000's sqm



Source: Knight Frank Research

Major office supply

Major Refurbishments

#	ADDRESS	SQM	COMPLETION
1	250 St Georges Terrace (QV1)	21,306	H1 2024
2	186 St Georges Terrace	3,920	H1 2024

Development Approved

#	ADDRESS	SQM	COMPLETION
6	1 & 21 Mounts Bay Road	20,000	Mooted

Under Construction / Major Pre-commitment

#	ADDRESS	SQM	COMPLETION
3	1 Spring Street	13,681	H1 2024
4	9 The Esplanade	32,000	H1 2025
5	Lot 4 Elizabeth Quay	69,000	H1 2027

Development Application / Mooted / Early Feasibility

#	ADDRESS	SQM	COMPLETION
7	235-239 St Georges Terrace	7,340	n/a
8	1-9 Mount Street	31,512	n/a

Rental growth positive while incentives decline

RAPID RENTAL GROWTH IN A STRONG MARKET

The pace of prime rental growth has remained elevated as Premium and upper A-grade space remains highly sought. Average prime net face rents increased by a substantial 6.8% over the past 12 months to average $713/sqm. This positioned Perth alongside Brisbane as the two best performing CBD office markets nationally, with face rents now having grown by 13.7% over the past two years.

Premium rents remain the major driver of prime rental growth, although rental growth has occurred across all grades including secondary assets which have seen solid growth of 3.6% over the past year.

With a decline in vacancy for prime assets it is conceivable that gross face rents will surpass the psychological barrier of $1,000/sqm in the next 12 months given current market momentum.

With limited supply of premium space in the short-term, leasing activity will pick up in the upper-A grade segment. Looking ahead, prime rental growth is expected to continue, with a forecast uplift in net face rents of 3.8% over the coming five years.

NOTABLE IMPROVEMENTS TO INCENTIVES ACROSS GRADES

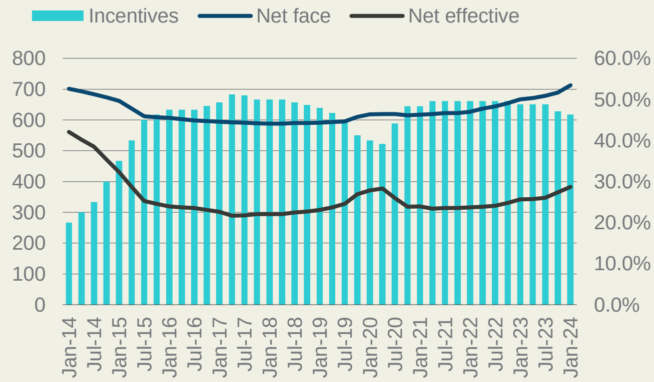
Alongside face rental growth, a reduction in incentives in both prime and secondary markets is breathing positivity into the markets and contributing to even stronger growth in effective rents.

The average prime incentive has been declining since its peak of 49.6% in July 2022, however, over the year to January 2024 this decline accelerated, easing a further 2.5% to 46.3% and contributing to double-digit net effective growth of 12.0% y/y.

The decline in incentives is reminiscent of the decline experienced prior to the pandemic, and in keeping with this experience we anticipate that incentives will tighten further over the next 12 months.

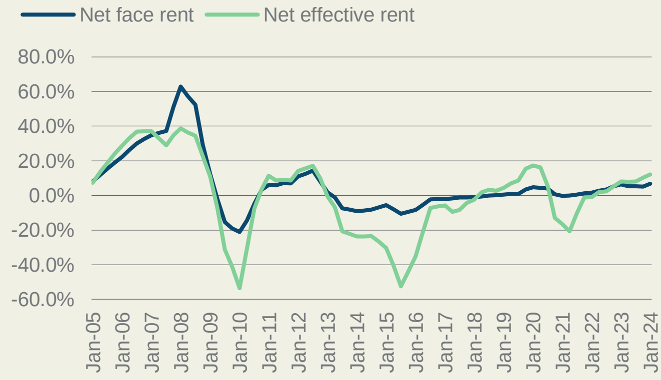
The secondary market in Perth has also shown a marked improvement in incentive levels with a decrease of 2.5% over the year to January 2024 to reach 51%, a level not experienced for three years. This has been aided by substantial CAPEX expenditure that has been occurring in secondary assets in recent years. This has further strengthened the position of secondary both for owners and occupiers.

Prime rents and incentives
by $/sqm (LHS), and % (RHS)



Source: Knight Frank Research

Perth CBD prime rental growth
by percentage change y/y



Source: Knight Frank Research

West Perth remains strong

NEW MINERALS AND MINING UNDERPINNING DEMAND

West Perth continues to benefit from solid levels of tenant demand including from SMEs across multiple sectors including new energy miners and businesses focused on the extraction of rare earths. Consistent demand has driven down vacancy in recent years and supported rent growth.

Sustained demand in West Perth highlights its complementary role alongside the larger CBD market. Larger businesses, including the major resource groups, are naturally focused on premium accommodation in the CBD, while West Perth tenants seek a different offering encompassing convenience, efficiency and relative affordability.

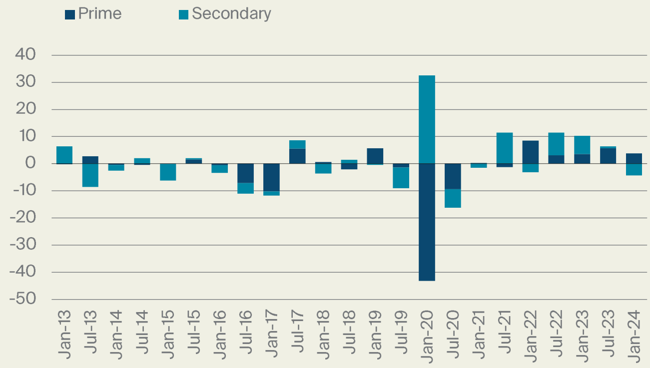
WEST PERTH INCREASINGLY RECOGNISED AS A VIABLE NON-CBD OPTION

The vacancy rate in West Perth stands at 12.1%, up 1.0% in H2, largely owing to 6,643 sqm of new supply completions, including 1-5 Harvest Terrace and the full refurbishment of 578 Murray Street.

Within this overall figure, A-grade vacancy is now 5.0%, down from 5.3% in July 2023 and 11.4% at the start of 2023, while B-grade vacancy stands at 15.6%.

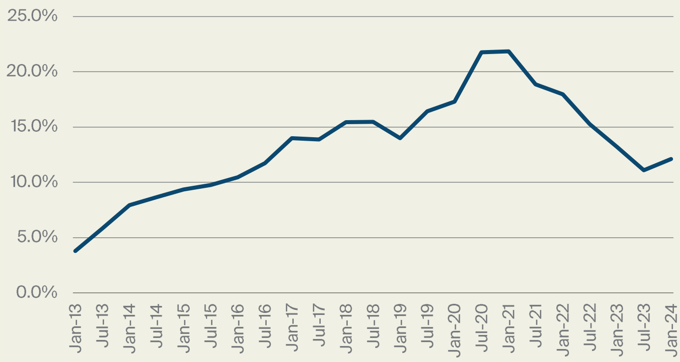
However, vacancy still decreased by 1.1% in the 12 months to January and the sub-lease vacancy is sitting at 0.5%, a strong result compared to CBD-adjacent and suburban markets in other cities which are grappling with more substantial sublease availability and high overall vacancy rates.

West Perth net absorption
by grade, 000's sqm



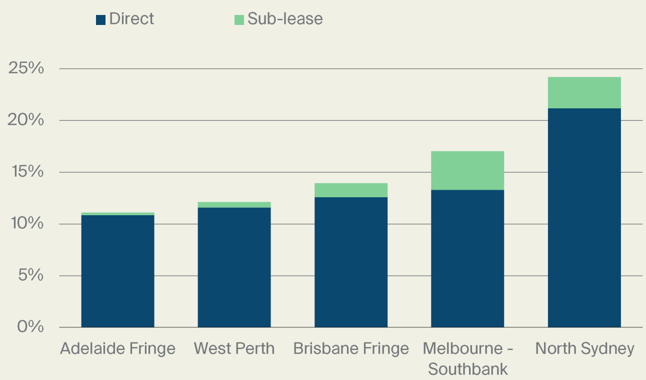
Source: Knight Frank Research, PCA

West Perth vacancy rate



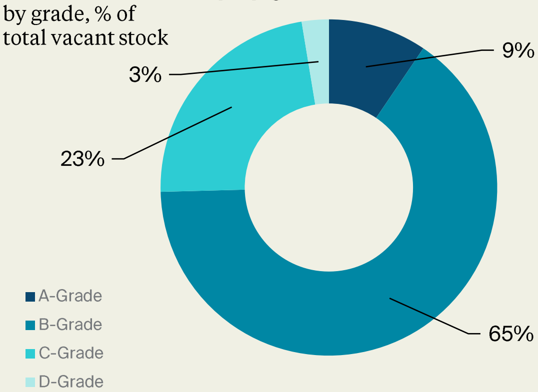
Source: Knight Frank Research, PCA

Vacancy in CBD-adjacent markets nationally



Source: Knight Frank Research, PCA

West Perth vacancy by grade
by grade, % of total vacant stock



Source: Knight Frank Research, PCA

Transaction volumes remain low – outlook improving

YIELDS START TO STABILISE

After a significant outward shift over the past two years, in the last quarter yields have begun to stabilise. Having drifted out from an average prime yield of 6.29% in 2021-22 to 7.04% mid-2023, yields steadied to average at 7.00% at the end of the year. Similarly secondary yields have remained unchanged ending 2023 at 8.13%.

Sales evidence from the Perth CBD has been limited with one transaction on the edge of the CBD core and the other occurring off-market in Q4. Nonetheless, book values are adjusting in keeping with the wider national trend and there has been a clear impact on pricing.

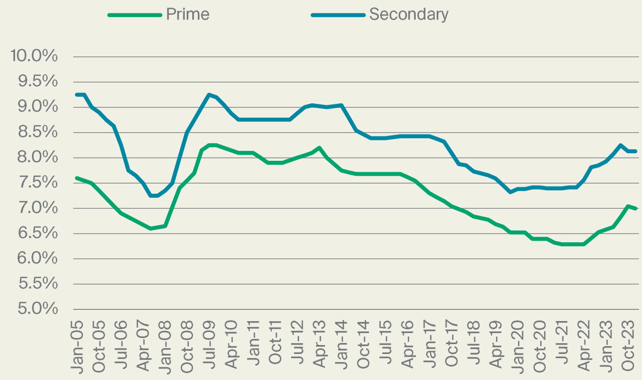
The gap between prime and secondary yields, whilst notable, at 123 bps, is judged to be lower than the 135 bp spread 12 months ago off the back of the improved leasing market performance of many secondary assets.

TRANSACTIONS VOLUMES TO IMPROVE AS SENTIMENT PICKS UP

Ongoing economic uncertainty and sustained periods of rate hikes have subdued office markets nationally, with investors taking a wait-and-see approach and vendors hoping for an improvement in sentiment before launching campaigns. While not as adversely affected as the major east coast capitals, Perth CBD has nonetheless been impacted with few transactions occurring and wide bid-ask spreads.

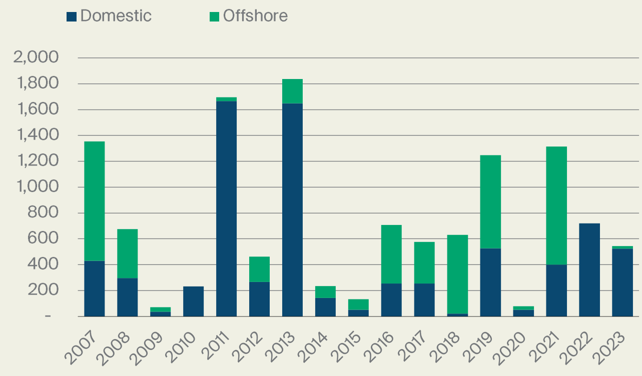
However, after several consecutive declines in inflation figures in Australia and global rates falling quickly, markets are turning to focus the potential for interest rate cuts later in 2024 or in 2025. As a result, sentiment in office markets is improving and Perth stands to benefit from improving liquidity in the second half of the year off the back of its robust occupier market.

Perth CBD office yield spread
by grade, % (LHS) and bps (RHS)



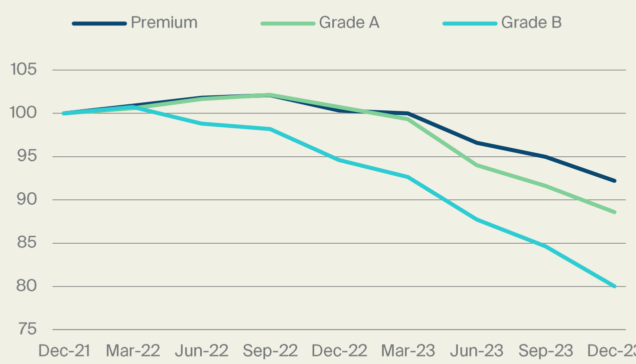
Source: Knight Frank Research

Perth CBD office sales $10m+
by investor type and domicile, $m



Source: Knight Frank Research, RCA

MSCI valuation indices since end 2021
Capital value index by grade, December 2021 = 100



Source: Knight Frank Research, MSCI

Recent transactions

Property	Price $m	Core Market Yield % (cap rate)	NLA sqm	$/sqm NLA	WALE	Purchaser	Vendor	Sale Date
10 William Street	21.0	9.08	4,248	4,943	2.4	Stanley College	Private	Q4-23
503 Murray Street	33.2	7.47	7,299	4,552	0.2	Properties & Pathways	Fairworld Holdings	Q3-23

Source: Knight Frank Research

We like questions, if you've got one about our research, or would like some property advice, we would love to hear from you.

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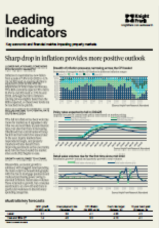
Recent Research



Economic Indicators Report

Build to rent report

Melbourne CBD Office Market – March 2024

Sydney CBD Office Market – Feb 2024


Active Capital Report 2024


The Wealth Report 2024

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