

- *WA economy outperforming*
- *Leasing market activity has picked up strongly*
- *Investment activity rises sharply*



Perth CBD Office

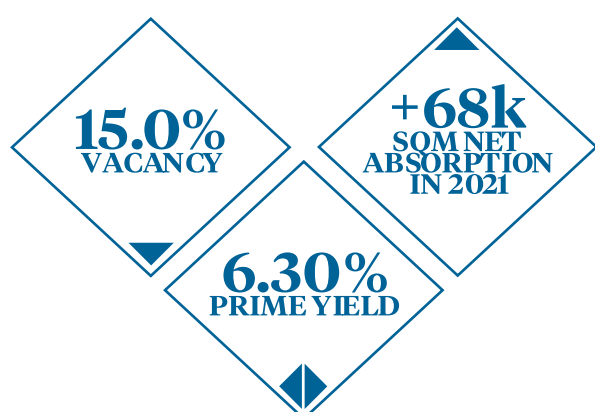
Market Report, March 2022

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DEMAND FOR OFFICE SPACE RISES SHARPLY

The Perth CBD recorded the largest increase in net absorption of the CBD markets in 2021 reflecting the city's favourable economic conditions and strong employment growth.



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“The Perth office market went from strength to strength in 2021 with high levels of demand driving vacancy sharply lower to levels not seen since the mid-2010s.”

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The Key Insights

The CBD vacancy rate declined further in H2 2021, falling from 16.8% to 15.0% reflecting strong demand for office space.

Net absorption rose by 47,853 sqm in H2 2021 to be 67,550 sqm higher over the calendar year, the largest increase of any CBD market.

Reflecting lower vacancy, face rents are edging higher. Prime net face rents rose by 0.7% in the six months to January 2022 to be 1.6% higher over the year. Average prime incentives remained unchanged at 49.6%.

Investment activity rose strongly in 2021, with investment volume totalling \$1.01 billion, over five times higher than 2020 and 18% above 2019 levels.

The outlook for the Perth market is positive. We expect strong net absorption to drive vacancy down further this year, with growth in net face rents picking up to around 3%. Face rental growth is then expected to remain strong over the next five years, increasing by over 4% per annum.

City CBD Office Market Indicators – January 2022

GRADE	TOTAL STOCK SQM	VACANCY RATE%	ANNUAL NET ABSORPTION SQM	ANNUAL NET ADDITIONS SQM	AVERAGE NET FACE RENT \$/SQM	INCENTIVE %	EFFECTIVE RENTAL GROWTH % YoY (NET)	CORE MARKET YIELD %*
Prime	1,034,554	11.5	27,602	-8,009	626	47-52	-0.9	6.15-6.45
Secondary	737,281	20.0	39,948	-14,815	388	50-56	0.9	7.20-7.65
Total	1,771,835	15.0	67,550	-22,824				

Source: Knight Frank Research/PCA *assuming WALE 50 years

PERTH RECORDS STRONGEST NET ABSORPTION AMONG CBD MARKETS

Buoyant economic conditions in WA

The WA economy continues to perform strongly compared to the rest of Australia. Consumer spending remains strong, with retail sales in WA rising by 28.3% from the pre-COVID level compared with 17.7% for Australia. Underpinning robust consumer spending, labour market conditions are healthy in WA. Employment has risen by 6.2% since the onset of the pandemic, the strongest growth of any state or territory and more than twice the national growth rate.

The WA economy is also set to benefit from the sharp rise in commodity prices seen in recent months. The RBA's index of bulk commodity prices rose by 34% in the first two months of this year, while base metals prices were 12% higher.

Commodity and energy prices have risen further in March following Russia's invasion of Ukraine. While rising energy and commodity prices will flow through to higher inflation with the potential to adversely affect global growth, the WA economy is set to benefit through higher resources sector income.

Strong economy driving demand for office space

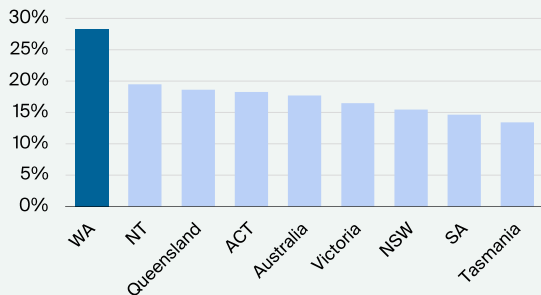
Reflecting the strong level of economic activity in WA, the Perth office market is experiencing a sustained rise in demand for office space. Total net absorption increased by 47,853 sqm in H2 2021 following a 19,697 sqm increase in the first half of the year. Perth recorded the strongest net absorption among the major CBD markets in 2021 at +67,550 sqm.

The prime segment accounted for 62% of the increase in demand for office space in H2 2021, driven by a 27,902 sqm increase in net absorption in the A grade segment. In the secondary market, net absorption rose by 18,334 sqm mostly reflecting take-up of B grade stock.

Demand for office space is expected to remain strong in the near-term, boosted by the recent reopening of the WA border which will facilitate stronger employment growth, while higher commodity prices have the potential to drive greater resources sector investment and employment.

Retail sales by state

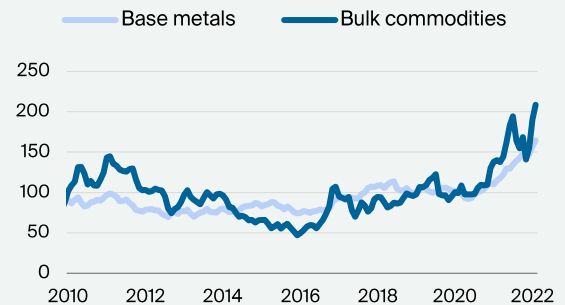
Percent change since January 2020



Source: Knight Frank Research, Macrobond

RBA commodity price index

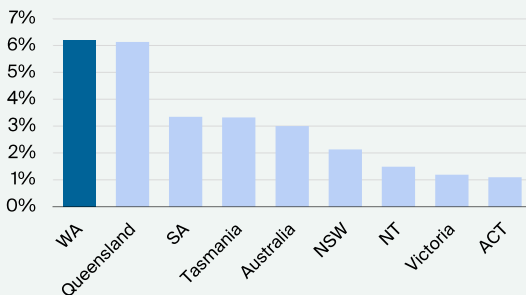
Index, 2019/20 = 100



Source: Knight Frank Research, Macrobond

Employment growth by state

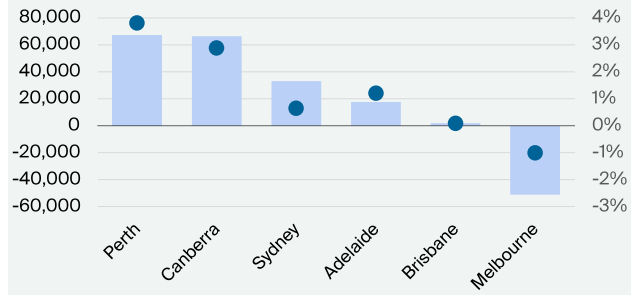
Percent change since January 2020



Source: Knight Frank Research, Macrobond

Net absorption in 2021 by major CBDs

Sqm (lhs), percent of total CBD office stock (rhs)



Source: Knight Frank Research, PCA

STRONG DEMAND DRIVES VACANCY LOWER

Vacancy declines across all market segments

The Perth CBD vacancy rate fell from 16.8% in July 2021 to 15.0% in January 2022, with the prime vacancy rate declining by 1.6 percentage points to 11.5%, while vacancy in the secondary market fell by 2.1 percentage points to 20.0%. Within the prime market, vacancy for A grade stock declined by 2.5 percentage points to 14.7%, while the premium vacancy rate edged lower to 6.7%.

The substantial fall in vacancy came despite 25,055 sqm of (mostly A grade) development completions (18,542 sqm in net terms after withdrawals) in H2 2021, with the partial recognition of the delivery of Capital Square Tower 2 and several refurbishments.

Vacancy set to fall further

We expect demand to remain high this year, supported by ongoing strong employment growth following the reopening of WA's border. The potential for recent increases in

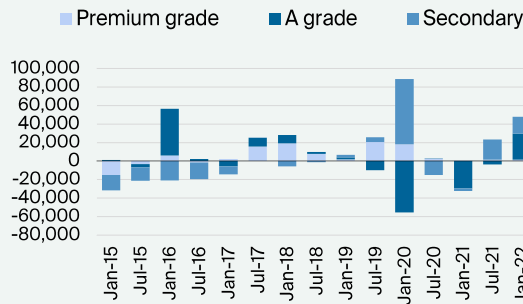
commodity prices to drive more resource sector investment and the shift towards renewable energy generation also pose upside risks for demand for office space.

Development completions look set to be limited over the next five years. Westralia Square 2 is likely to reach completion at the end of this year and will add 9,300 sqm of new supply, while Chevron's new headquarters at One The Esplanade (54,000 sqm of office space) is due to be completed in H2 2023. Further out, Lot 6 Elizabeth Quay is expected to add 32,000 sqm in H2 2025.

Reflecting the combination of well above-average demand and modest levels of new supply, we expect the vacancy rate to decline steadily over the next few years to around 10% by the end of 2025. However, the development of a further 70,000 sqm at Lot 4 Elizabeth Quay before the end of 2025 would significantly impact the forecast market recovery.

Net absorption

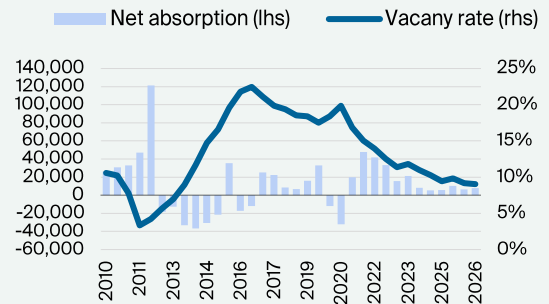
By grade, sqm



Source: Knight Frank Research, PCA

Net absorption and vacancy rate

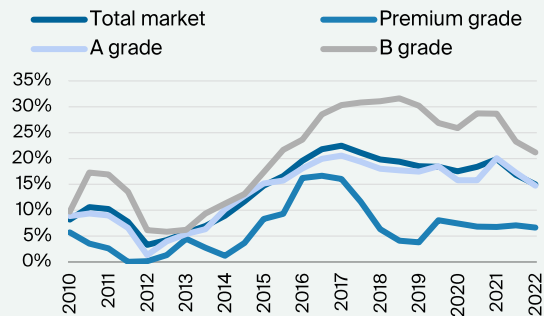
Sqm (lhs), percent (rhs)



Source: Knight Frank Research, PCA

Vacancy rate

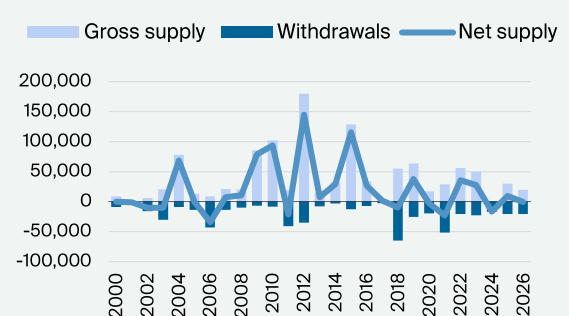
By grade, percent



Source: Knight Frank Research, PCA

Supply and withdrawals

Sqm



Source: Knight Frank Research, PCA

MAJOR OFFICE SUPPLY



MAJOR REFURBISHMENTS

- 1 DYNONS PLAZA (90 5 HAYS STREET) - 13,200 SQM
REDHILL PARTNERS. H1 2022

UNDER CONSTRUCTION/ MAJOR PRE-COMMITMENT

- 2 WESTRALIA SQUARE 2 (141 ST GEORGES TERRACE) – 9,300 SQM
GDI. H2 2022
- 3 LOTS 7 & 8 ELIZABETH QUAY (ONE THE ESPLANADE) – 54,000 SQM [CHEVRON]
BROOKFIELD. H2 2023

DEVELOPMENT APPROVED

- 4 LOT 4 ELIZABETH QUAY – 70,000 SQM
CA & ASSOCIATES. TBC
- 5 LOT 6 ELIZABETH QUAY – 32,000 SQM
BROOKFIELD. H2 2025
- 6 PERTH CONVENTION CENTRE PRECINCT (21 MOUNTS BAY ROAD) – 20,000 SQM
BROOKFIELD. H2 2026
- 7 1 MILL STREET – 45,000 SQM
GDI/LENDLEASE. DATE TBC

FACE RENTS RISE ON LOWER VACANCY

Growth in face rents gains momentum but incentives remain high

Prime net face rents rose by 0.7% over the six months to January 2022 to \$626/sqm to be 1.6% higher over the year. For the premium segment, face rents increased by 0.6% over the same period to \$676/sqm, 1.6% higher over the year. For the A grade segment, face rents rose by 0.7% over the six months to January to \$577/sqm to be 1.5% higher over the year.

Average prime incentives remained unchanged over the six months to January at 49.6% but were still 1.25 percentage points higher over the year. Average incentives in the prime market are around mid-2018 levels, and 162 basis points lower than the peak in April 2017.

Reflecting stable incentives, prime net effective rents grew at the same pace as face rents over the six months to January to \$316/sqm but are down 0.9% over the year.

In the secondary market, net face rents rose by 0.5% over the six months to January to be 1.3% higher over the year. Net effective rents also increased by 0.5% over the same period and are 0.9% higher over the year.

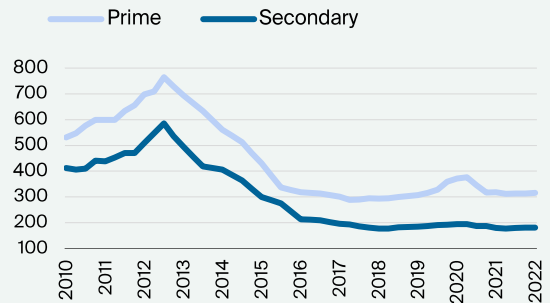
The average rental discount between the prime and secondary market remains relatively high at 38% in face terms and 43% in effective terms compared to the historical averages of 31% and 32% respectively.

Lower vacancy to drive stronger face rent growth even as incentives remain high

Reflecting strong leasing market conditions and declining vacancy over the next few years, growth in face rents is set to pick-up significantly. Net face rents are expected to rise by around 3% this year and grow by over 4% per annum over the next five years.

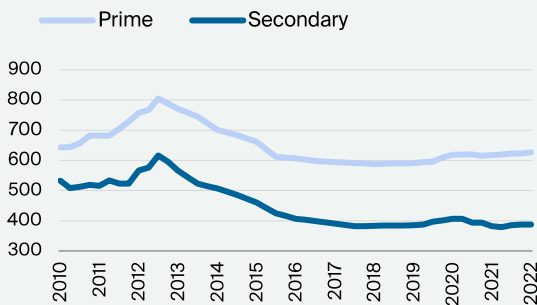
The tightening leasing market is also set to put some downward pressure on incentives. Average prime incentives are expected to gradually fall from their current level of just under 50%. However, incentives are likely to remain relatively high over the next few years, reflecting tenant preferences for higher face rents coupled with high incentives over lower face rents and lower incentives. Net effective rents are expected to grow by well over 5% per annum over the next five years.

Net effective rent
By grade, \$/sqm



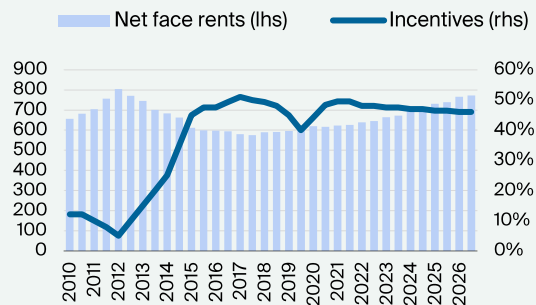
Source: Knight Frank Research

Net face rent
By grade, \$/sqm



Source: Knight Frank Research

Prime rents and incentives
Net, \$/sqm (lhs), percent (rhs)



Source: Knight Frank Research

INVESTMENT ACTIVITY ECLIPSES 2019 LEVELS

Investment activity rebounds sharply to be above pre-pandemic levels

Investment in the Perth CBD has picked up strongly last year following the low level of activity in 2020. Investment volume totalled \$1.01 billion in 2021, over five times higher than in 2020 and 18% above 2019 levels.

The increase largely reflects several major deals in early to mid-2021 including Dexus' acquisition of a 49% stake in the holding unit trust that owns Capital Square Tower 1 in July for \$339 million, Blackrock's and Primewest's joint acquisition of 140 St Georges Terrace for \$260 million in April, and GIC's purchase of a 25% stake in One The Esplanade from Brookfield for \$220 million in February.

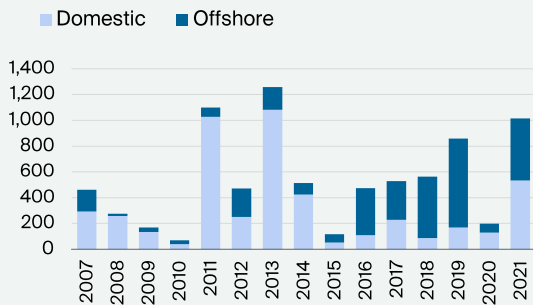
Prime yields remain stable

The average prime CBD office yield remained unchanged over the six months to January at 6.30% but was 10 basis points lower over the year. The average premium and A grade yields are 6.15% and 6.45% respectively.

At the same time, nominal market interest rates have risen, with the 10-year Australian government bond yield rising by 70 basis points in 2021 to 1.7%, and a further sharp increase over 2022 to date to 2.7%. The rise in bond yields has led to narrowing in the Perth CBD prime office yield spread to 462.2 basis points at the end of last year, down from 480.7 basis points in mid-2021, and 542.6 basis points at the end of 2020.

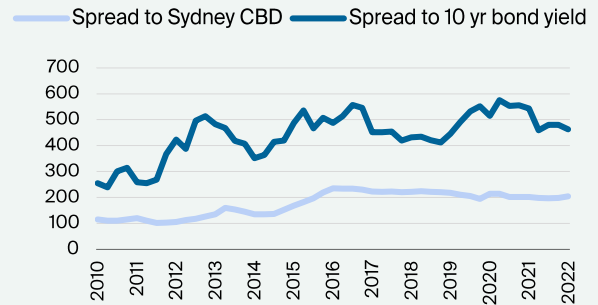
Perth is relatively well insulated from the potential adverse impact of higher nominal interest rates on office asset prices. The average office property yield prevailing in Perth is considerably higher than in other major Australian markets.

Perth CBD office investment volume
\$ million, transactions greater than \$10 million



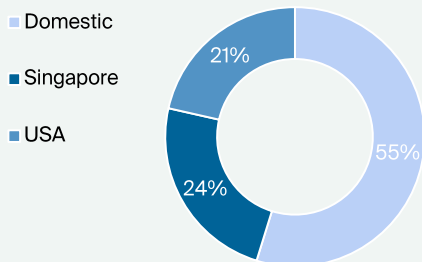
Source: Knight Frank Research

Prime yield spread
Basis points



Source: Knight Frank Research

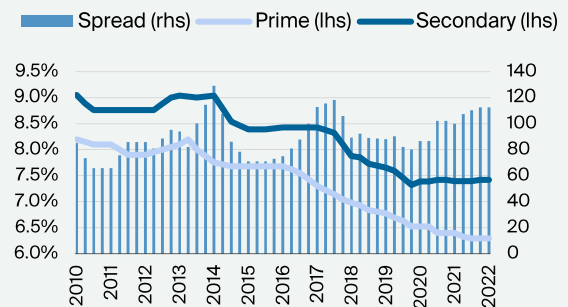
Perth CBD office investment by country
2020 and 2021, transactions greater than \$10 million



Source: Knight Frank Research

Yields

Percent (lhs), basis points (rhs)



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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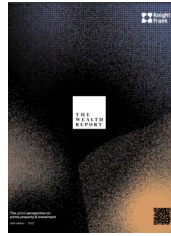
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