

- *Sustained positive net absorption*
- *Acceleration in rental growth*
- *Yields edge out further*



Perth CBD Office

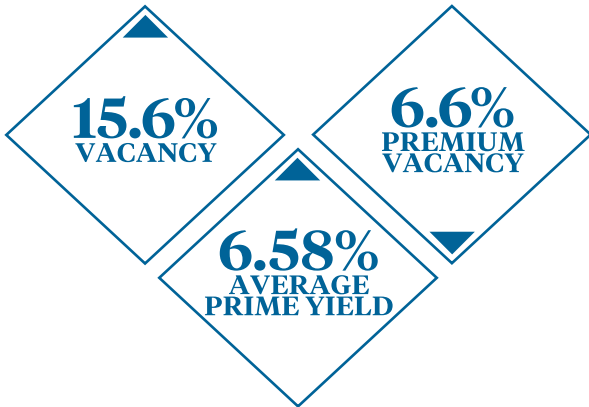
Market Report, March 2023

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MIXED SIGNALS AS RENTS GROW WHILE YIELDS RISE

A sustained run of positive absorption and the strength of the WA economy has prompted a return to rental growth



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“Rents are growing and absorption remains positive. Limited new supply beyond 2023 will enable vacancy to drift lower over time as existing A and B grade space is gradually taken up”

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The Key Insights

Positive absorption of 6,000 sqm in H2 2022, and 87,000 over the past two years.

Vacancy has decreased marginally over the last year to move to 15.6%. Premium grade vacancy remains low, however 2023 supply additions will be significant.

Supply additions to reach 79,000 sqm in 2023; the highest annual addition since 2015.

Prime and secondary rents grew in 2022, with incentives reducing.

Widening in office yields has continued and increasingly we observe divergence between Premium and A grade assets, with premium more resilient.

City CBD Office Market Indicators – February 2023

GRADE	TOTAL STOCK SQM	VACANCY RATE %	NET ABSORPTION SQM	NET ADDITIONS SQM	AVERAGE NET FACE RENT \$/SQM	INCENTIVE %	EFFECTIVE RENTAL GROWTH % YoY (NET)	CORE MARKET YIELD %*
Prime	1,062,918	12.8	828	10,335	651	48.8	5.6	6.58
Secondary	743,874	19.8	5,258	-6,872	415	52.3	9.5	7.93
Total	1,806,792	15.6	6,086	3,463				

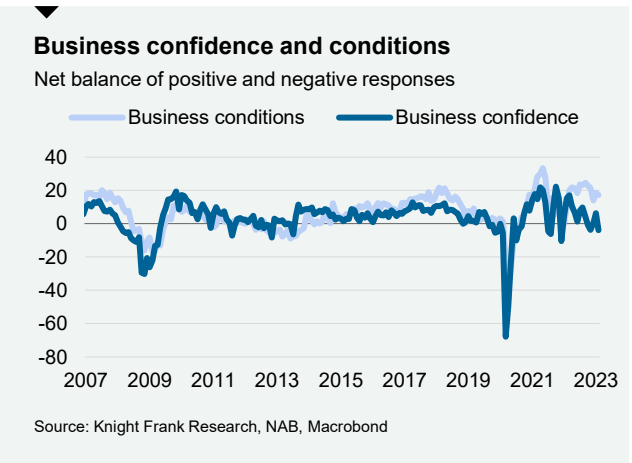
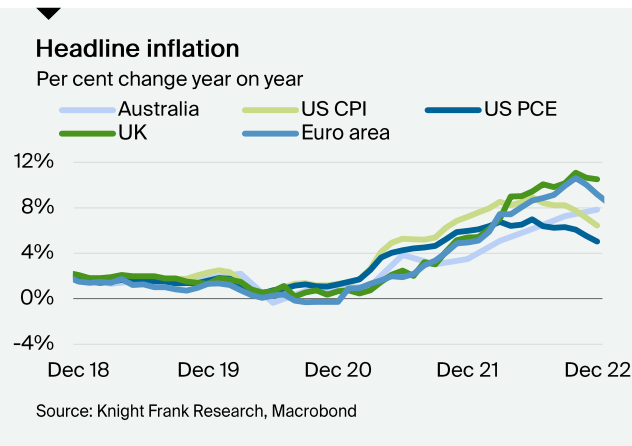
Source: Knight Frank Research/PCA *assuming WALE 5.0 years

PRIME REMAINS SOUGHT AFTER IN TIGHTENING MARKET

Emerging headwinds to growth nationally but WA is outperforming

After an extended period of strong growth, we are seeing signs that the Australian economy is slowing in response to high inflation, cost of living pressures, and the dramatic shift in interest rates. Australia’s Q4 GDP growth was solid at 0.5% q/q, but this reflected a significant slowing in the pace of growth compared to early 2022. The slowdown was due to a substantial moderation in consumer spending, as consumers respond to reduced disposable income. While consumer sentiment is close to historic lows, businesses continue to report strong trading conditions, though recent months have seen a widening gap between current conditions and forward expectations which are weaker and likely reflect recognition of a subdued outlook for consumer spending in the near term.

Of the states, WA continues to perform well, having seen the strongest growth in employment over the past three years (8.6%). WA also continues to benefit from elevated bulk commodity prices and significant volumes of construction activity across a number of sectors.

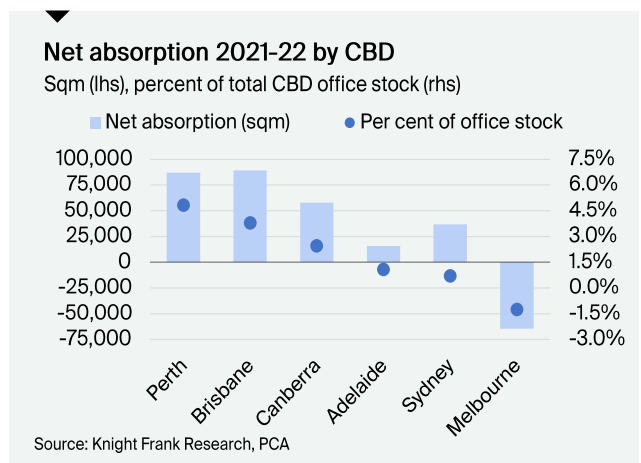
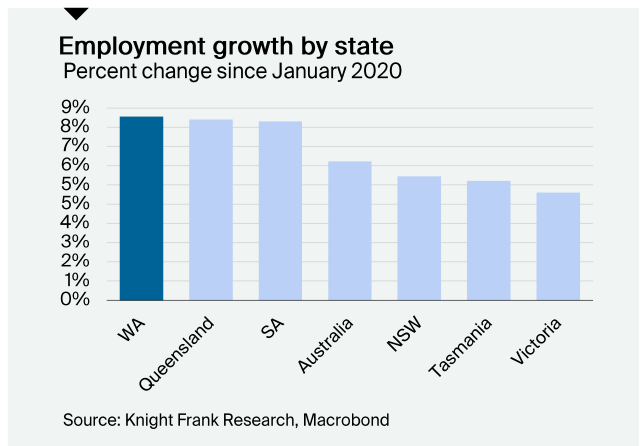


Sustained positive absorption in Perth CBD

Reflecting the sustained strength of economic and employment growth, Perth CBD has recorded a high level of net absorption over the past two years and this continued in H2 2022, with over 6,000 sqm recorded, bringing the total over the past two years to 87,000 sqm. This reflects 4.8% of total stock, the highest of any major CBD over the past two years.

Absorption of B grade (41,000 sqm) and A grade (37,000 sqm) space has been particularly strong over this period. The resilient performance of B grade is in contrast with other major cities which have seen a more pronounced concentration of absorption in Premium and A grade.

Looking ahead, whilst business confidence is subdued, the pace of recent employment growth and the resulting very tight labour market augur well for sustained office demand. Businesses and consumers alike are waiting for pause in interest rate rises and for signs that inflation has peaked, and this will help restore confidence in H2.



CBD OFFICE MARKET SUPPLY REMAINS LIMITED

Vacancy rates differ substantially by grade

The overall vacancy rate contracted slightly in H2, down by 0.2% to stand at 15.6%. Over the full year, vacancy was slightly up as the completion of Capital Square Tower 2 and several refurbishments slightly offset positive absorption.

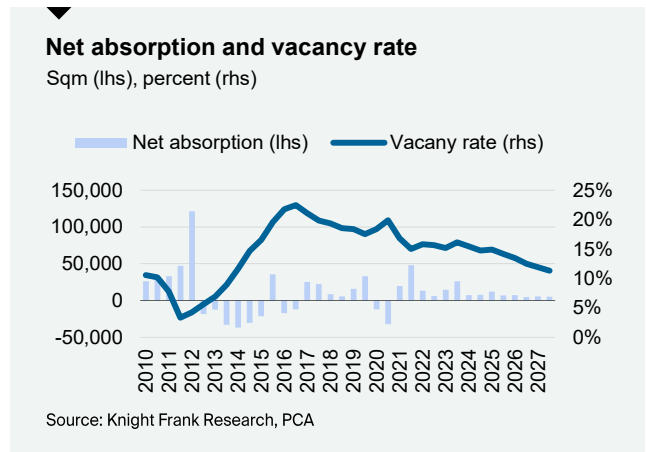
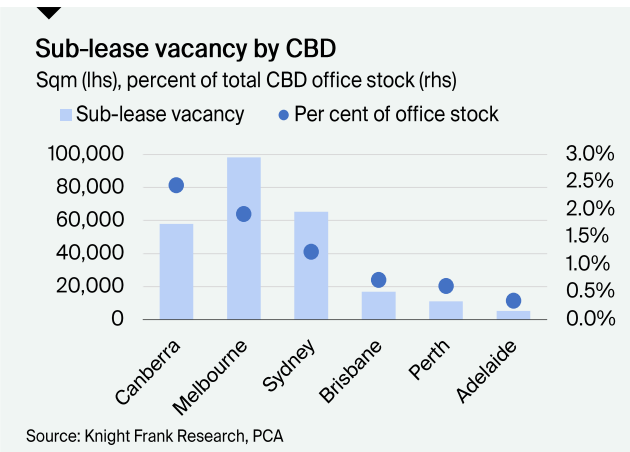
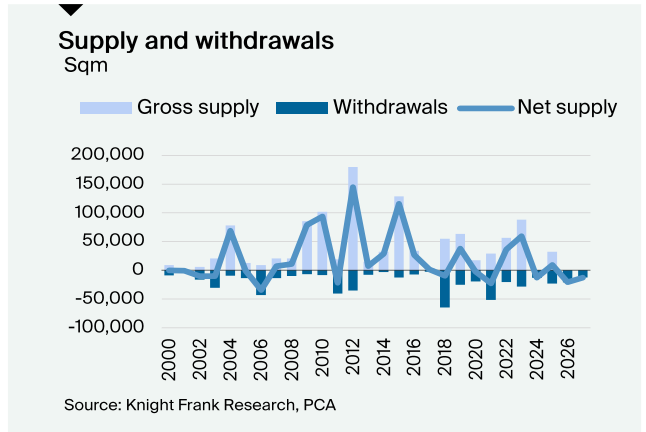
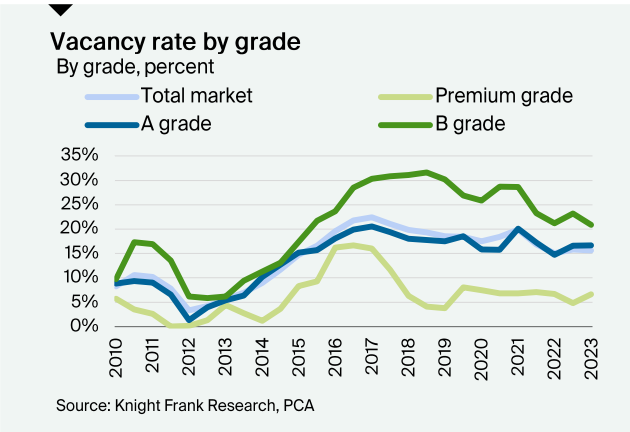
Vacancy remains tightest in Premium grade at 6.6%, but this jumped up from 4.8% in mid-year and will be further impacted by the completion of One The Esplanade and the backfill space created, most notably, by Chevron at QV1. There is substantially more availability in A grade which saw vacancy broadly stable at 16.7% and B grade, which saw vacancy contract from 23.2% to 20.9%.

A notable feature of the Perth market is its comparative lack of sub-lease vacancy. Other cities, led by Canberra and Melbourne, are experiencing elevated rates of sub-lease availability as major tenants seek to downsize, but this is not occurring in Perth, where sub-lease vacancy is currently 0.6% of total stock, the lowest since 2012.

High level of completions in 2023

2023 is set to see a high level of development completions, with Brookfield's new Premium grade 52,000 sqm HQ and Capital Square Tower 3 (16,000 sqm) both expected to reach completion. This injection of new supply is likely to see overall vacancy tick up somewhat this year. Further out, Brookfield's 32,000 sqm development at 9 The Esplanade (Lot 6 Elizabeth Quay) is expected in 2025.

At present, however, there is no new supply scheduled to compete in 2024 or 2026, and this will help to facilitate the ongoing recovery of the CBD market. With an outlook for sustained office demand and limited new supply beyond 2023, we expect the vacancy rate to decline steadily over the next few years to around 12% by the end of 2026. However, the potential development of a further 70,000 sqm at Lot 4 Elizabeth Quay could significantly impact the forecast market recovery.



WEST PERTH RESURGENT

Buoyant office demand driving down vacancy in West Perth

West Perth has seen a resurgence in demand, as evidenced by two consecutive years of buoyant net absorption, with 22,000 sqm in 2022 coming on top of 16,000 sqm in 2021. This represents the strongest demand for West Perth since 2007-08.

The market has clearly re-emerged as a viable CBD-adjacent option for many tenants, aided by plentiful parking availability and relative affordability compared to CBD market.

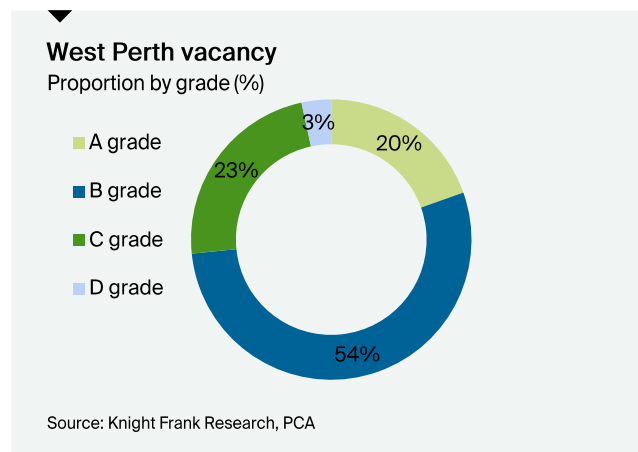
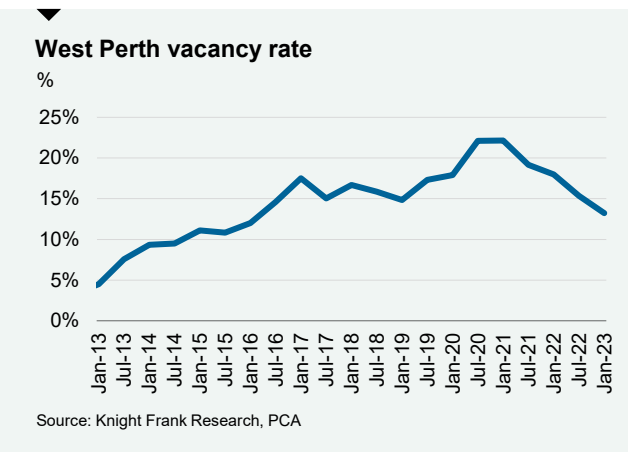
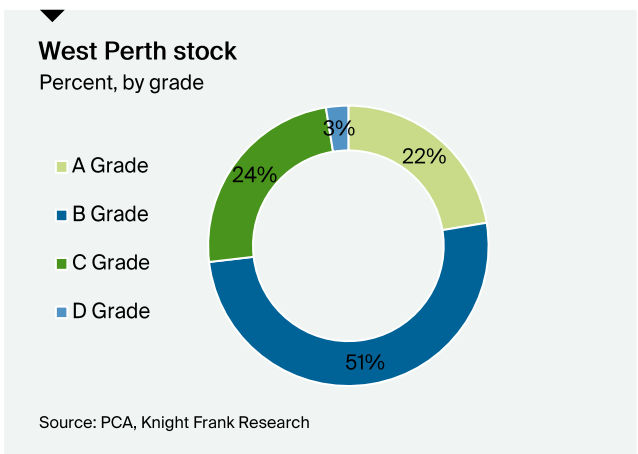
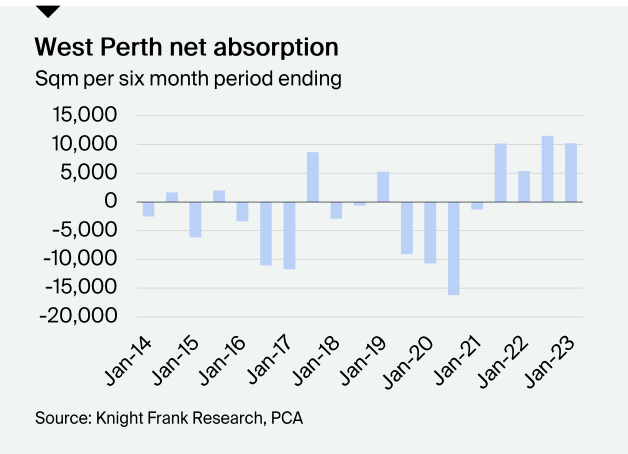
Off the back of this sustained demand, vacancy in West Perth has dropped substantially from 22.1% at end 2020 to 13.2% currently. Current availability is predominantly B grade space, in keeping with its profile of office stock.

West Perth more resistant to current work from home trend

The resurgence of West Perth can be attributed to the recent performance of WA commodities and the consequential growth of many emerging mining and exploration businesses which gravitate to West Perth. Secondly, the trend of working from home has had far less impact due to the smaller size of the occupiers in West Perth who are more inclined to attend the office.

Recent withdrawals due to acquisition by owner occupiers, and limited new additions have accelerated the recovery.

Looking forward there are no new developments under construction or with DA approvals in place, which should further improve occupancy levels in the West Perth office market.



MAJOR CBD OFFICE SUPPLY



MAJOR REFURBISHMENTS

- 1 INTERNATIONAL HOUSE (26 ST GEORGES TERRACE)- 10,614 SQM
H1 2023

DEVELOPMENT APPROVED

- 5 LOT 4 ELIZABETH QUAY – 70,000 SQM
CA & ASSOCIATES. TBC
- 6 PERTH CONVENTION CENTRE PRECINCT (21 MOUNTS BAY ROAD) – 20,000 SQM
BROOKFIELD. H2 2026

DEVELOPMENT APPLICATION/MOOTED/EARLY FEASIBILITY

- 7 1 MILL STREET– 45,000 SQM
GDI/LENLEASE. TBC
- 8 CORNER PIER STREET AND WELLINGTON STREET – 27,000 SQM
GDI PROPERTY GROUP TBC

UNDER CONSTRUCTION/ MAJOR PRE-COMMITMENT

- 2 CAPITAL SQUARE TOWER 3 – 16,000 SQM
AAIG. H2 2023
- 3 LOTS 7 & 8 ELIZABETH QUAY (ONE THE ESPLANADE) – 52,000 SQM [CHEVRON]
BROOKFIELD. H2 2023
- 4 LOT 6 ELIZABETH QUAY (9 THE ESPLANADE) – 32,000 SQM
BROOKFIELD. H1 2025

RENTAL GROWTH ACCELERATES FURTHER

Strong prime and secondary rent growth

Prime net face rents rose by a further 2.2% over the six months to January 2023 to average \$651/sqm, 3.9% higher over the year. Within this prime average, Premium rents average \$699/sqm and A grade rents stand at a lower \$617/sqm.

In addition to face rental growth, Perth experienced a reduction in incentives during 2022. Average prime incentives reduced slightly to 48.8%, having stood at 49.6% a year ago. After escalating rapidly with the onset of the pandemic, average incentives in the prime market have now dropped back to around mid-2018 levels, 240 basis points lower than the peak in April 2017.

Aided by the reduction in incentives, prime net effective rents grew by a healthy 3.9% over the six months to January 2023, to \$334/sqm. This reflected annual growth of 5.6%, a faster pace than the East Coast markets of Sydney and Melbourne.

Rental growth was even stronger in the secondary market, where net face rents rose by 3.9% over the six months to January to be 5.6% higher over the year. With incentives also reducing in secondary assets, effective rents grew rapidly, 9.5% over the full year.

The average rental discount between the prime and secondary market remains relatively high at 36% in face terms and 41% in effective terms compared to the historical averages of 31% and 32% respectively.

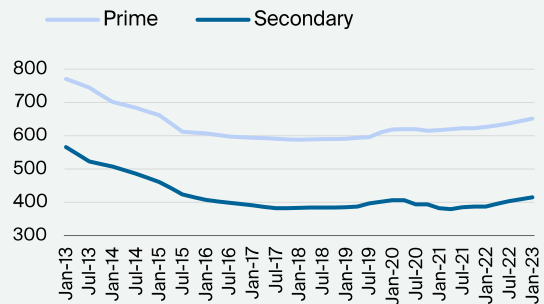
Potential to out-perform in the recovery phase

Reflecting ongoing above-average demand, a modest supply outlook beyond 2023 and high inflation, prime rents are expected to continue to grow, although at a slightly slower pace than in 2022.

Perth's recent history and the fact that rents remain well below previous peaks, suggest that it has the potential to out-perform other markets in the recovery from the pandemic. Related to this, the limited supply pipeline will allow the market to gradually return to a lower rate of vacancy and this will help to maintain the recent growth trajectory.

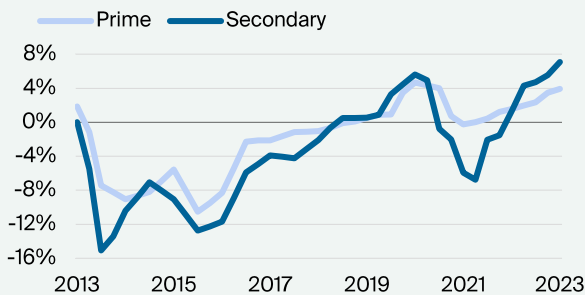
Reflecting the national experience, effective rent growth is likely to come primarily in the form of face rental growth while incentives remain elevated.

Net face rent
By grade, \$/sqm



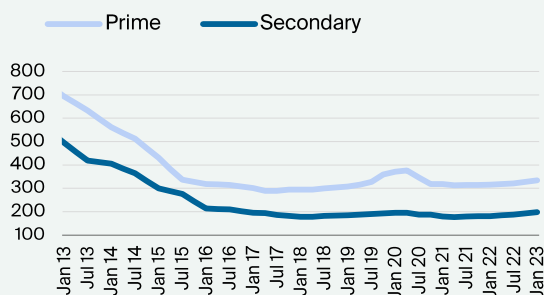
Source: Knight Frank Research

Net face rental growth
y/y %



Source: Knight Frank Research

Net effective rent
By grade, \$/sqm



Source: Knight Frank Research

HIGHER FUNDING COSTS WEIGH ON MARKET

Low volume of transactions nationally

Nationally across all the major sectors, higher funding costs and protracted uncertainty over the outlook for interest rates are resulting in deals taking longer to transact. This resulted in a relatively subdued Q4 with few large deals taking place.

However, compared to other CBD office markets, Perth saw relatively strong deal volumes in 2022 led by Realside and Lendlease’s acquisition of 108 St Georges Terrace for \$340 million and the acquisition of Allendale Square by Centuria and MA Financial for \$223 million.

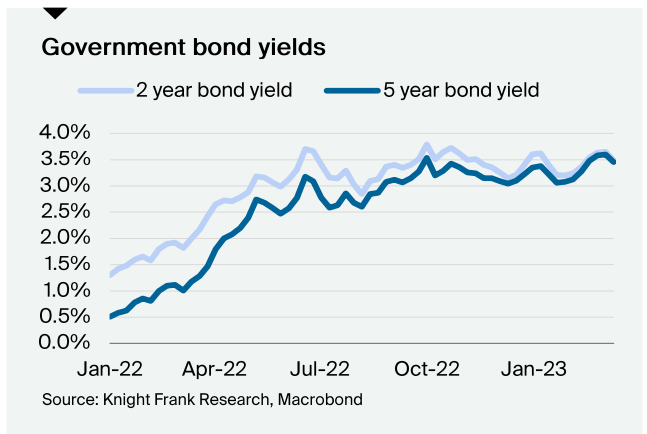
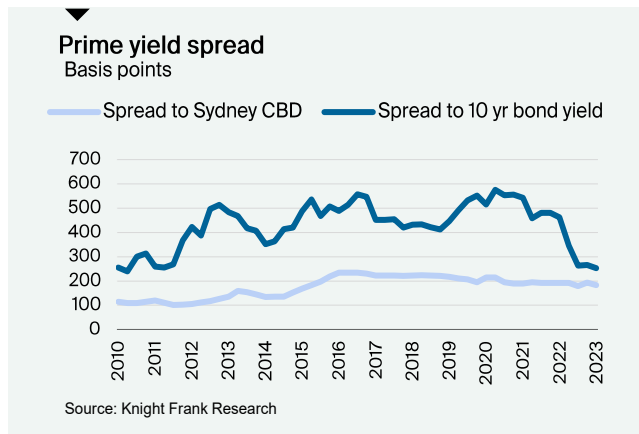
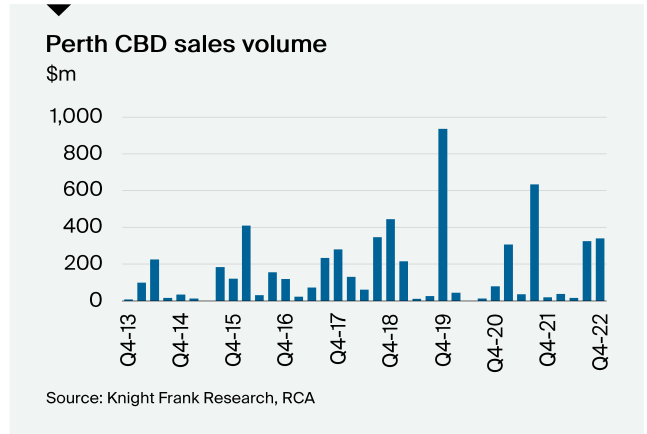
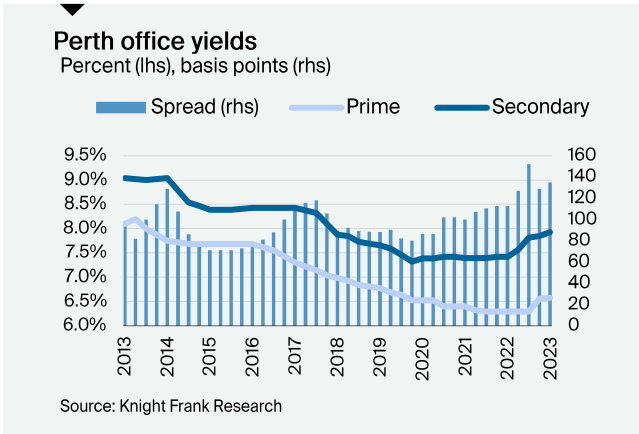
While the cash rate continues to rise, the cost of debt has stabilised over recent months, with two-year and five-year bond yields holding in the range of 3.0 – 3.5% after escalating sharply during the first half of last year. Recent comments from the RBA have been taken to indicate that a pause in rate rises is soon to be expected, and this will help to restore greater confidence to the outlook for funding costs.

Yields have continued to rise

Reflecting the sharp rise in funding costs since early 2022, prime yields have continued to edge upwards across all markets. In Perth the average prime yield now stands at 6.58%, up by around 30 bps from 6.29% in July.

However, within this there is significant divergence between Premium and A graded assets, with the Premium market showing greater resilience to current market pressures. Premium yields stand at 6.20% on average, markedly lower than the A grade average of 6.90%.

The divergence partly reflects perceptions of income security and long term growth potential, with investors prepared to factor in greater future rental uplift for Premium assets as opposed to A grade.



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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