RESEARCH

Knight Frank

PERTH CBD

OFFICE MARKET OVERVIEW SEPTEMBER 2018

HIGHLIGHTS

Occupier activity during the first half of 2018 was subdued, with a lack of major tenant moves and no changes to supply. Stronger activity will occur during the second half, and into 2019.

Prime effective rents have turned the corner as a result of incentives declining from their elevated levels over the past 24 months. Tenant demand for prime buildings will drive further effective growth.

Transactional activity in 2018 has been clearly segmented; with prime assets purchased by national funds and syndicates, whilst secondary value add opportunities have been the domain of offshore capital.

KEY FINDINGS

With limited significant occupier moves during the first half of 2018, **subdued absorption of 8,581 sqm** was recorded, reducing the total **vacancy rate by 0.4% to 19.4%**.

Prime effective rents grew 3.4% compared with July 2017, and are forecast to continue to grow as incentives erode, whilst the **secondary market declined a further -3.3%**.

Demand from large tenants has crept up, with a lack of prime modern buildings with contiguous floor availability to select from. This is expected to drive a new round of supply.

Six significant transactions in 2018 have displayed **yield compression for both prime and secondary assets**.

NICHOLAS LOCKE
Analyst — Research WA

ECONOMIC OVERVIEW

Driven by sustained growth in commodity prices, the outlook for Western Australia appears brighter; with improving business confidence levels, and a rebound in State Final Demand.

Familiar patterns re-emerge as mining capex returns

Despite intent at diversification towards a broader range of industries, improving sentiment towards the Western Australian economy has emerged in line with commodity price growth and new project announcements that have followed.

Where deteriorating prices instigated economic decline from 2012 onwards as investment dried up, their increase again appears to be the impetus for recent growth. Since January 2016, the RBA's Index of Commodity Prices has grown 45%, mineral exploration has increased 40%, and metals and mining companies listed on the ASX/S&P 300 have experienced price growth of 102%.

This strong performance has resulted in commitment to numerous large scale projects; most notably BHP's $4.60 bn 'South Flank', and FMG's $1.70 bn 'Eliwana'; iron ore mines projected to deliver 4,500 construction jobs.

Public sector spend also to increase and deliver jobs

Following a period of tighter fiscal management, the State Government has secured Federal funding for a range of transport infrastructure projects.

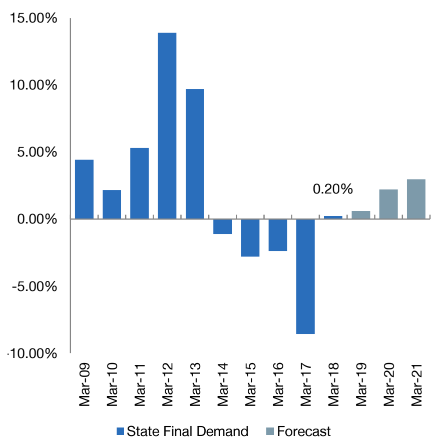
Metronet rail projects are budgeted at $4.40 bn, with a mandate to manufacture new rail cars with 50% local content.

State Final Demand back in the black

State Final Demand measures the total value of goods and services sold without incorporating the direct impact of merchandise exports; a factor heavily influencing the usefulness of Gross State Product as an economic indicator for WA.

Final demand has turned positive for the first time since 2013, driven by increases in household and public demand. Improving business sentiment will be expected to translate to improvement in other components over the next 12 months, contributing to office demand.

FIGURE 1
WA State Final Demand
% change, average annual basis



Source: Knight Frank Research/Deloitte Access Economics

TABLE 1
Perth CBD Office Market Indicators as at July 2018

Grade	Total Stock (m²)	Vacancy Rate (%)	Annual Net Absorption (m²)	Average Net Face Rent ($/m²)	Average Incentive (%)	Average Core Market Yield (%)
Prime	1,081,288	13.2	37,938	540—640	45—50	6.50—7.25
Secondary	687,777	28.9	-7,179	340—410	50—55	7.25—8.25
Total	**1,769,065**	**19.4**	**30,759**			

Source: Knight Frank Research/PCA

TENANT DEMAND & ABSORPTION

Net Absorption & Outlook

Prime	FY18 37,938 sqm 75% y-o-y	
Secondary	FY18 –7,179 sqm -16% y-o-y	

Source: Knight Frank Research/PCA

Improving conditions driving large tenant moves

Encouraging signs in the Perth CBD have continued, with positive absorption of 8,581 sqm recorded during the first half of 2018 to mark the third successive increase since the beginning of 2017.

Whilst modest, the result is not unexpected, with large unresolved requirements in the market from the likes of FMG, WA Police, Mineral Resources, ConocoPhillips, Rio Tinto, and ABN Group scheduling moves beyond 2019.

Activity from larger occupiers has occurred as a result of a number of factors, both endogenous to the Perth office market, and more broadly tied to an improved outlook aligned with the Western Australian economy.

Knowledge of decreasing availability of contiguous space, indications incentives are beginning to ease, and a supply pipeline not forecast to deliver any new stock until 2020+ (outside of Capital Square) have driven large occupiers to negotiate well in advance of expiries, and lock in deals today.

A good indicator of this sentiment is the decline of sublease availability to 1.2%; 0.4% below the 20 year average. Even if contracted space may exceed current requirements, tenants are reticent to sublease space that may be needed as the economy improves.

True to form, large occupiers in the market are well represented by mining and oil and gas companies, anticipating additional space requirements as new projects commence or beckon.

Long-term leases signed in the lead up to the resources boom are approaching expiry. Tight supply upon commencement forced some occupiers into sub-optimal space, and the current market provides opportunities to relocate into prime buildings on competitive terms.

Net absorption to remain positive into 2019

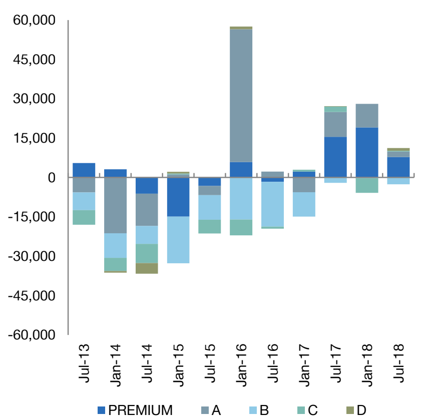
Following the departure of Woodside, the availability of 240 St Georges Terrace to incoming tenants will occur in late 2018 to early 2019. Knight Frank's analysis of the known take-up thus far indicates incoming tenants will occupy an additional 5,263 sqm over their previous footprint in the CBD.

> "Decreasing availability of contiguous space, incentives beginning to ease, and a supply pipeline not forecast to deliver any new stock until 2020+ have driven large occupiers to negotiate well in advance of expiries, and lock in deals today"

Strong pre-commitment to space at 240 St Georges Terrace, and 14,192 sqm of take-up within KS1 at Perth City Link both demonstrate a combination of tenant expansion and further relocation from suburban areas.

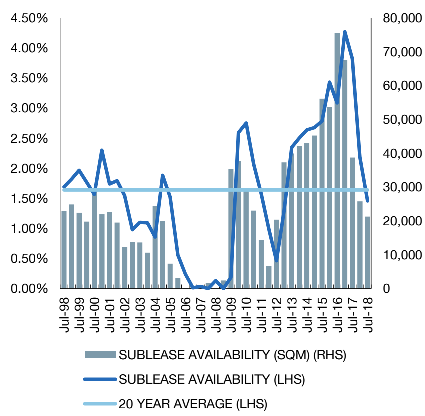
Continuation of this trend, in addition to the resolution of other large outstanding space requirements, will bode well for continued absorption into prime stock moving into 2019; whilst demand for secondary buildings will remain weak.

FIGURE 2
Perth CBD Net Absorption
('000m²) per 6 month period by grade



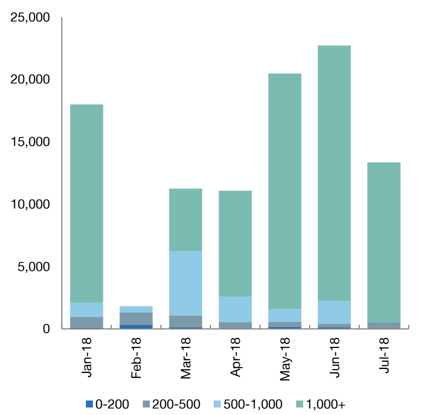
Source: Knight Frank Research/PCA

FIGURE 3
Perth CBD Sublease Availability
% & sqm of vacant stock per 6 month period



Source: Knight Frank Research/PCA

FIGURE 4
Perth CBD Tenant Rep Enquiry
Sum of requirements by area, per month



Source: Knight Frank Research

SUPPLY & DEVELOPMENT

Vacancy Rate & Outlook

Prime	13.2% -207bps y-o-y	↘
Secondary	28.9% +101bps y-o-y	→

Source: Knight Frank Research/PCA

Prime and secondary vacancy rates are still on divergent paths

The differential between prime and secondary vacancy rates has been gradually widening since January 2013, to the extent where secondary buildings are now (on average) more than twice as vacant as their prime counterparts.

The premium vacancy rate of 4.1% (or 14,681 sqm) is spread across buildings, and other than Central Park there is no significant block of space appropriate for tenants with larger requirements.

A grade space comprises 41% of all stock in the CBD, and as such the level of accommodation between offerings varies significantly.

Those of higher quality that have suffered from elevated vacancy can now expect to benefit from being amongst the best options available to tenants in the market.

First new stock completion since early 2016

As the only office building under construction since early 2016, the 100% pre-committed 98 Mounts Bay Road has attracted a high degree of interest.

The market has been awaiting the fall-out from approximately 42,000 sqm of back-fill space hitting the market to be vacated by Woodside, however with the availability of this space imminent, the impact to the CBD appears limited.

The success in the leasing of this space without any significant detriment to competing stock to date has coincided with an increase in demand from larger occupiers, allaying earlier fears.

Modern, functional buildings leasing well

The supply pipeline that emerged as a result of stronger office conditions in the previous cycle has generally been well absorbed during a period of weakness.

Of the 225,000 sqm of stock added to the Perth CBD since January 2015 (including 98 Mounts Bay Road), only 21,700 sqm is currently vacant, reflecting a 9.6% vacancy rate. Excluding non-core eastern locations, this figure drops to 7.1%.

Supply pipeline to emerge over the next 6 months

Improving sentiment in the economy, a falling prime vacancy rate, a lack of contiguous floor-space available in modern buildings, and increasing large tenant demand has provided an impetus for developers to investigate opportunities within the first half of 2018.

The most notable addition will be a new 52,785 sqm premium grade building at the Chevron-owned Lot 7 Elizabeth Quay, to be developed by Brookfield (and owned on completion). Chevron will announce a final decision in late 2018, with the building to be occupied by 2023.

Brookfield's Elizabeth Quay exposure is extended further with ownership of Lots 5 & 6, where a two tower mixed use development comprising approximately 50,000 sqm of office space is proposed.

Further mooted supply proposals will advance over the next 6 months, subject to securing pre-commitment.

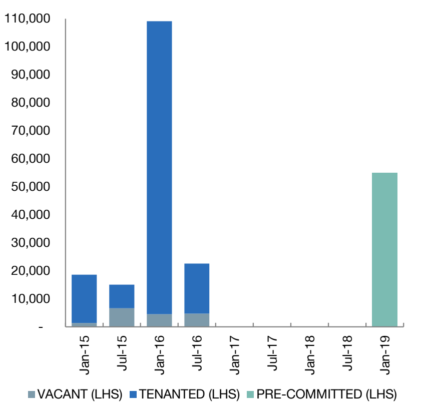
Considered most likely are Brookfield's proposal on land adjacent to the Perth Convention and Exhibition Centre along Mounts Bay Road; with a tenant understood to be courted for pre-commitment, and Devwest's developing proposal at Lot 10 Perth City Link.

TABLE 2
Perth CBD—Vacancy Rates

Precinct	Jan 18	Jul 18
Premium	6.3%	4.1%
A Grade	18.0%	17.7%
Prime	**14.2%**	**13.2%**
B Grade	31.1%	31.6%
C Grade	23.1%	22.9%
D Grade	31.6%	18.7%
Secondary	**28.8%**	**28.9%**
Totals	**19.8%**	**19.4%**

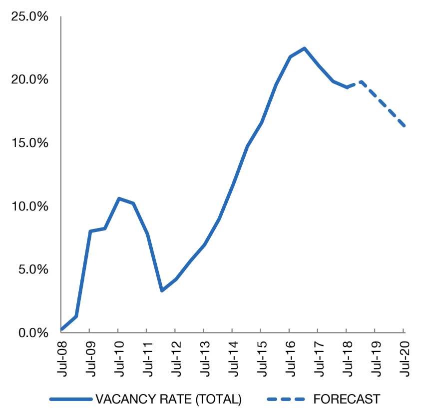
Source: Knight Frank Research/PCA

FIGURE 5
Perth CBD New Supply and Vacancy
sqm additions, tenanted and vacant at Aug 18



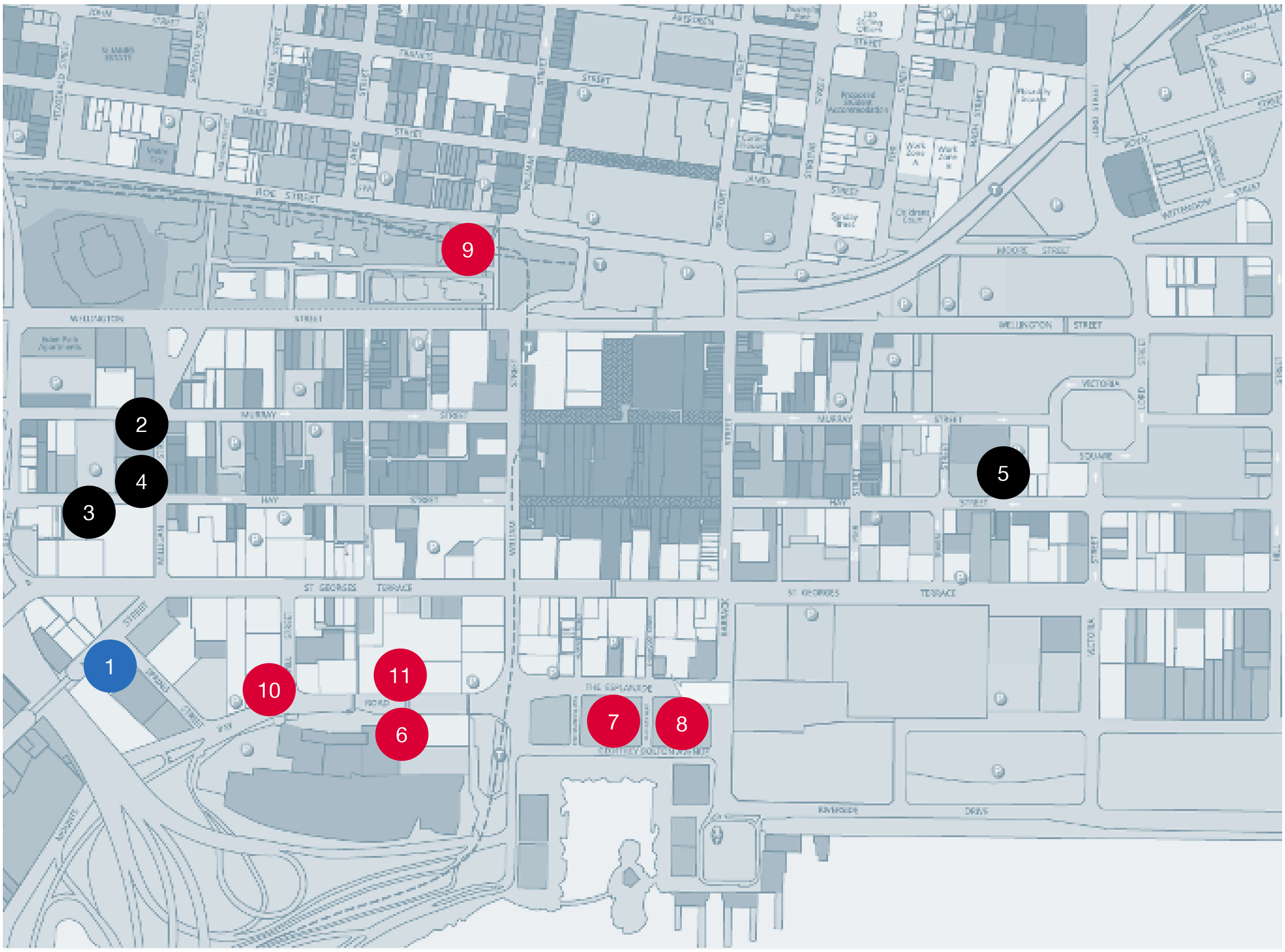
Source: Knight Frank Research/PCA

FIGURE 6
Perth CBD Vacancy
% total vacancy



Source: Knight Frank Research/PCA

MAJOR OFFICE SUPPLY



1. 98 Mounts Bay Rd—approx. 55,000m²
AAIG
Ready for occupation Q4 2018
100% committed [Woodside]

2. Cnr Milligan St & Murray St—10,000m²
Fragrance Group
New DA Approved July 2018

3. QV2 & QV3 —10,916m² & 19,167m²
Investa / Commonwealth Super
Ground works complete^ for QV2
Deferred / Seeking pre-commitment

4. 950 The Melbourne—10,018m²
Oakesfield Pty Ltd
Ground works complete^
Deferred / Seeking pre-commitment

5. 480 Hay Street—34,450m²
BGC (For Sale)
Ground works complete^
Seeking pre-commitment / Unlikely

6. Mounts Bay Road—approx. 20,000m²
Brookfield
DA Lodged
Seeking pre-commitment

7. Lots 5 & 6 EQ—15,000 & 35,000m²
Brookfield
Mooted#
Estimated 2022-2023

8. Lot 7 EQ—52,785m²
Brookfield/Chevron
Mooted#
Estimated 2022-2023

9. Lot 10 PCL—approx. 35,000m²
Devwest
Mooted#—preferred proponent of MRA

10. 1 Mill Street—approx. 34,000m²
GDI Property Group
MoU signed with Lendlease to
investigate redevelopment options

11. 141 St Georges Tce—approx. 3,000m²
GDI Property Group
Mooted
Seeking pre-commitment

Under Construction / Complete

DA Approved / Confirmed / Substantial Commencement / Site Works

Development Application / Mooted / Early Feasibility

Source of Map: Knight Frank

As at August 2018
Avail office NLA quoted.
Major Pre-commit in [brackets] next to the NLA.
EQ Elizabeth Quay
PCL Perth City Link
# denotes areas under the auspices of the Metropolitan Redevelopment Authority
^ denotes substantial commencement of DA

RENTS & RECENT TRANSACTIONS

Rents, Incentives & Outlook

Prime Rents (n)	$590/sqm face -1.1% y-o-y $299/sqm eff +3.4% y-o-y
Secondary Rents (n)	$376/sqm face -1.6% y-o-y $179/sqm eff -3.3% y-o-y
Incentives	P: 49.3% S: 52.3%

Prime effective rental growth slowly emerging as incentives continue to ease

Prime net face rents remain reasonably unchanged at an average of $590/sqm; a level that has only eroded approximately 5% since mid-2015.

Incentives peaked over this period in early 2017 with deals regularly offering over 50%, often with added landlord works. In the past 12 months, a minor, albeit noticeable decline has emerged, with deals now more regularly struck in the range of 45% to 50%.In effective terms, this has lead to a slight uptick in effective rents of approximately 3.4%.

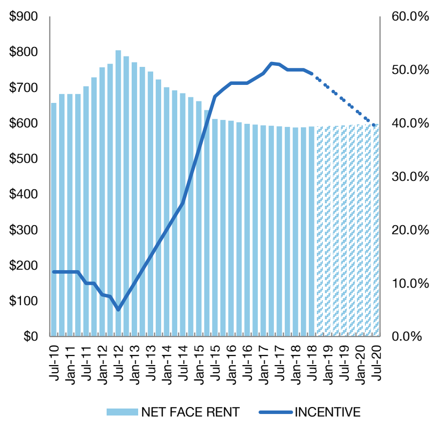
Of significant recent deals, those struck at King's Square 1 are understood to be in the range of low-to-mid $500's per sqm, whilst at 240 St Georges Terrace, deals are understood to be in the mid-$500's to low $600's with increasingly less pressure on the landlord as the availability declines. Incentives are in line with the above.

With space continually filling up within prime buildings and a strong level of enquiry in the market from larger occupiers, Knight Frank anticipates further effective rental growth will be achieved over the remainder of 2018 and beyond. Longer term growth will be determined in part by the supply pipeline.

FIGURE 7

Prime Face Rent & Incentive

LHS: $/m² p.a average face net
RHS: % incentive



Source: Knight Frank Research

Secondary rental performance far more tied to individual buildings

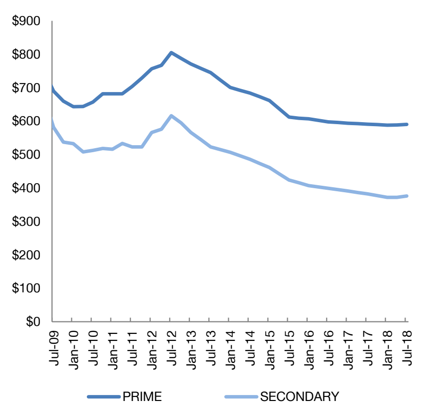
The inferior performance of the secondary market is well-established, with landlords attempting a variety of strategies to improve the desirability of space in their buildings.

As existing tenants depart, the limiting factor in employing these strategies to attract incoming tenants has increasingly become the ability or practicality to efficiently subdivide a floorplate in order to attract smaller tenants, which is often tied to the age of the construction.

FIGURE 8

Perth CBD Face Rents

$/m² p.a average prime v secondary



Source: Knight Frank Research

TABLE 3

Recent Leasing Activity Perth CBD

Address	NLA m²	Term yrs	Tenant	Start Date
226 Adelaide Terrace#	4,560	3	DHS	Q4 2018
556 Wellington Street	8,495	10	DHS	Not discl.
556 Wellington Street	3,249	10	P&N Bank	Q2 2019
556 Wellington Street	2,448	10	BG&E	Not discl.
240 St Georges Terrace	2,477	-	HWL Ebsworth	Q1 2019
240 St Georges Terrace	3,238	-	Iluka Resources	Q1 2019
240 St Georges Terrace	3,790	-	CBH Group	Q1 2019
240 St Georges Terrace	9,197	-	Wood Group	Q1 2019

Source: Knight Frank Research # unconfirmed

INVESTMENT ACTIVITY & YIELDS

Strong investment sales activity trending towards $1 billion

To date, six major transactions of office buildings have occurred within the Perth CBD and immediate surrounds in 2018, totalling approximately $350 million.

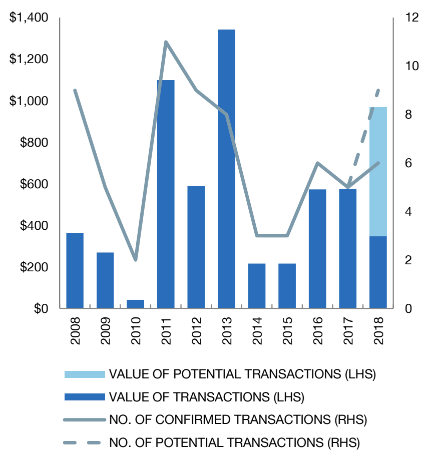
First quarter transactions were all for secondary buildings with higher vacancy, offering value-add opportunities at sub-$50 million price points, and acquired by offshore purchasers chasing yield.

More recently, modern long-WALE properties with strong tenant covenants at 836 Wellington Street and 202 Pier Street have transacted, achieving strong results and contributing to 12 month yield compression of around 30bps.

FIGURE 9

Perth CBD Transaction Volumes

2008—2018, $ millions



Source: Knight Frank Research

Current Yields & Outlook

Prime	6.50% - 7.25% -30bps y-o-y	↘
Secondary	7.25% - 8.25% -40bps y-o-y	↘

Appetite in the market for assets with these characteristics has prompted further vendor activity, with Warrington electing to market William Square in Northbridge; a fully refurbished building with Government tenants.

Estimated realisations of the above, a 100% interest in the premium grade Exchange Tower, and speculation of an Adelaide Terrace building being put to market suggest the 2018 transaction volume will approach $1 billion for the Perth CBD and immediate fringe, marking the strongest result since 2013.

Active interest from all purchaser types

The volume of transactional activity and tightening in yields observed has occurred from a variety of buyer types.

Since the beginning of 2017, all secondary value-add opportunities have been acquired by capital originating offshore, with a majority from Singapore.

Prime core opportunities have been limited in frequency, but have all been acquired by local/national syndicates and trusts. Offshore capital is still seeking these assets, but has not yet been successful.

Prime yield differential to Sydney now falling

The gap between Perth and Sydney prime risk-adjusted market yields has bridged slightly in early 2018, indicative of the calibre of assets to have transacted.

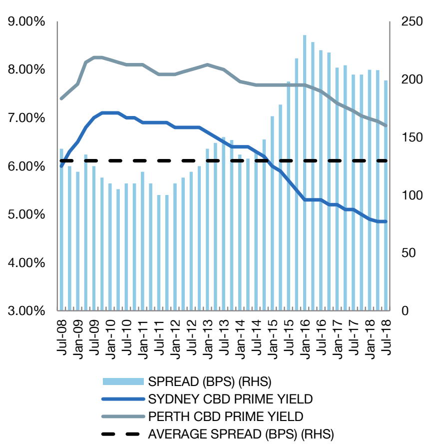
The potential sale of a 100% interest in Exchange Tower; a premium grade building that has completed a significant capital expenditure programme and secured strong tenants, will be a strong gauge of investor interest at the top end of the market.

Going forward, the differential between Perth and Sydney will be expected to close further as prime effective rents demonstrate sustained growth, and the local economy improves.

FIGURE 10

Perth vs Sydney Prime Yield Spread

2008—2018, core market yields



Source: Knight Frank Research

TABLE 4

Recent Sales Activity Perth CBD

Address	Grade	Price $ mil	Core Market Yield	NLA m²	$/m² NLA	WALE yrs	Vendor	Purchaser	Sale Date
836 Wellington Street#	A	91.33	6.25	11,973	7,628	8.5	Investa Office Fund	Growthpoint	Jul 18
202 Pier Street	A	125.25	7.05	15,602	8,028	7.3	Charter Hall	Elanor Investors	Jun 18
441 Murray Street	B	22.00	-	5,849	3,761	VP	Centuria	Redhill Partners	Mar 18
55 St Georges Terrace	B	44.20	7.43	8,630	5,122	1.3	Standard Life	Zone Q	Feb 18
182 St Georges Terrace	B	21.10	8.02	5,414	3,897	0.9	Standard Life	Zone Q	Feb 18

Source: Knight Frank Research #denotes fringe CBD location in West Perth

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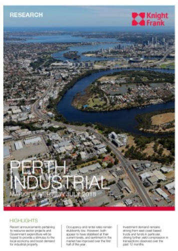

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