

- *WA economy continues to outperform*
- *Leasing market activity has picked up strongly*
- *Investment activity rises sharply as investors express confidence in Perth*



# Perth CBD Office

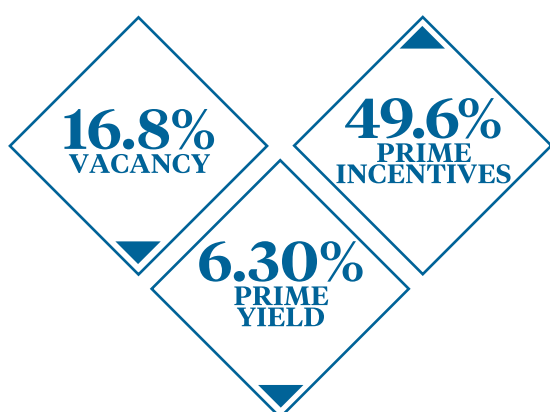
Market Report, September 2021

knightfrank.com/research



# STRONG PICK UP IN LEASING AND INVESTMENT ACTIVITY

*Investment activity has picked up strongly reflecting Perth's relatively attractive yields and investor confidence in the city's strong economic and office market fundamentals.*



**“The Perth CBD has emerged from the pandemic downturn with strong demand for office space and sharply higher investment activity.”**



## The Key Insights

The overall vacancy rate declined from 19.9% in January 2021 to 16.8% in July driven by withdrawals and higher net absorption. The vacancy rate fell sharply in the A grade and secondary market segments.

Demand for office space has picked up strongly, with net absorption rising by 19,697 sqm over the six months to July 2021 driven mostly by an increase in the B grade segment.

Prime face rents rose by 0.9% over the six months to July 2021. Average prime incentives appear to have stabilised at 49.6% as at July, up from 48.3% in January but unchanged over the past three months.

Investment activity has been strong over the year to date, with investment volume totalling \$841 million, over four times higher than the whole of 2020 and just 5% below 2019 levels.

The average prime yield fell by 10 basis points over the six months to July to 6.30%.

## City CBD Office Market Indicators – July 2021

GRADE	TOTAL STOCK SQM	VACANCY RATE %	NET ABSORPTION SQM	NET ADDITIONS SQM	AVERAGE NET FACE RENT \$/SQM	AVERAGE INCENTIVE %	EFFECTIVE RENTAL GROWTH % YOY	AVERAGE CORE MARKET YIELD %*
Prime	1,019,760	13.1	-1,917	-22,803	622	47-52	-9.3	6.15-6.45
Secondary	733,533	22.1	21,614	-18,563	385	50-56	-4.2	7.20-7.65
<b>Total</b>	<b>1,753,293</b>	<b>16.8</b>	<b>19,697</b>	<b>-41,366</b>				

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

# DEMAND FOR OFFICE SPACE IS RISING

## WA economy continues to strengthen amid near-term economic headwinds in other states

The WA economy continues to grow strongly. State final demand rose by 4.4% over the six months to June compared with a 3.6% increase in domestic final demand for Australia.

A strong pick up in private sector investment in Q1 made a significant contribution in growth in WA in the first half of year. Business investment rose by 9.2% over the six months to June, while dwelling investment increased by 15.6% over the same period supported by federal and state government incentives for housing construction.

Household consumption rose by 2.1% over the first half of the year. Retail sales in WA remain relatively strong, with turnover in July 17.8% above January 2020 levels compared to 7.3% for Australia.

Consumer confidence is relatively high in WA, with sentiment rising to 114.1 in August compared to 104.1 for Australia (a reading above 100 denotes optimism). Businesses in the state also remain more confident at +7.5 (net balance of positive and negative responses) than for Australia overall at -7.9, as lockdowns in NSW and Victoria weigh on sentiment.

WA exports have risen sharply driven by strong demand for iron ore from China. Over the year to July 2021, the value of the state's total goods exports (12-month rolling sum) rose by 26.6% while WA's goods exports to China increased by 46.6%. The large increase in the state's goods exports has been driven by exports of metal ores (most of which is iron ore), which rose by 43.4% over the same period, reflecting both higher export volumes and a strong rally in iron ore prices.

However, the price of iron ore has fallen sharply since mid-July after reaching a record high of around \$US230 per tonne in mid-May, partly reflecting a slowdown in global manufacturing and a Chinese government directive to domestic firms to lower their steel production. The iron ore price is currently around 40% off its May peak but remains high relative to history.

Western Australia is set to continue to perform strongly. Oxford Economics forecasts that gross state product (GSP) in WA will grow by 3.5% in 2021 and 3.6% in 2022.

## Strong economic activity is driving stronger demand for office space

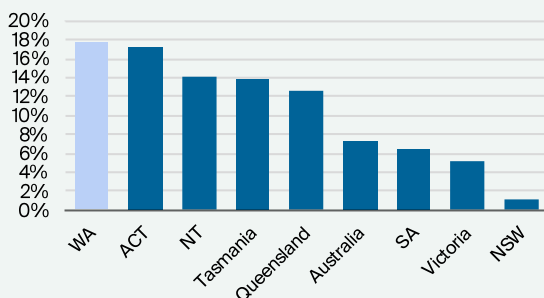
Reflecting the strong level of economic activity in WA, the Perth office market is experiencing a broad-based pick-up in demand for office space. The small tenant (sub-500 square metre) market is very strong, while demand for larger space requirements is picking up reflecting activity among some larger corporates and the state government.

Total net absorption rose by 19,697 sqm over the six months to July 2021, driven by a 21,614 sqm increase in net absorption in the secondary market (mostly B grade segment). In the prime market, a 1,691 sqm increase in net absorption in the premium grade segment was more than offset by a 3,608 sqm fall in the A grade segment.

Demand for office space is expected to strengthen significantly in the near-term, particularly when WA reopens its border to the eastern states (which will likely occur in early 2022), which will facilitate stronger employment growth.

### Retail sales by state

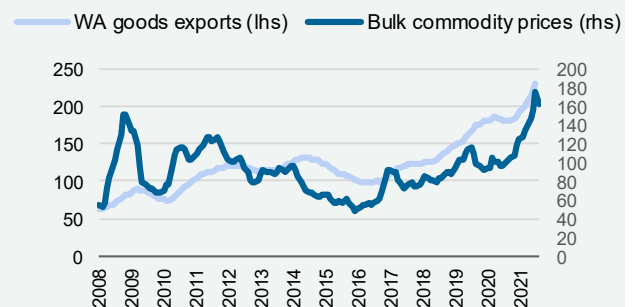
Percent change since January 2020



Source: Knight Frank Research, Macrobond

### WA goods exports and commodity prices

12-month rolling sum, \$b (lhs), index, 2019/20 = 100 (rhs)



Source: Knight Frank Research, Macrobond

# STRONGER DEMAND TO DRIVE VACANCY LOWER

## Decrease in vacancy in A grade and secondary segments mostly reflecting stock withdrawals

The Perth CBD vacancy rate fell from 19.9% in January 2021 to 16.8% in July, reflecting a 2.8 percentage point decline in vacancy for A grade stock to 17.3% and a 5.4 percentage point decrease in vacancy in the B grade segment to 23.3%. By contrast, the premium vacancy rate increased slightly over the same period from 6.8% to 7.1% reflecting a small increase in net supply.

The overall prime vacancy rate fell from 14.8% to 13.1%, while secondary market vacancy declined by 4.8 percentage points to 22.1%.

The fall in vacancy was driven by 46,206 sqm of withdrawals (mostly of A grade and B grade stock) and by higher net absorption (19,697 sqm). A total of 4,840 sqm in new supply was completed in the six months to January.

## Vacancy set to fall further in 2022 as demand for office space strengthens

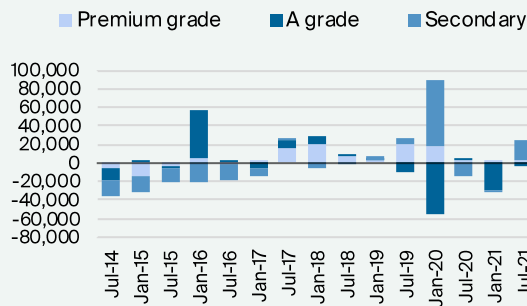
Ongoing strong net absorption in 2022, supported by higher employment growth as WA reopens its border to the rest of Australia, is likely to drive the vacancy rate to below 16% by the end of next year.

The supply pipeline is around average levels over the next couple of years. Capital Square Tower 2 will deliver 25,200 sqm of office space later this year. Westralia Square 2 is likely to finish completion at the end of 2022, which will add 9,300 sqm of new supply, while several refurbishments are expected to add a combined 23,814 sqm in the same year.

Chevron's new headquarters at One The Esplanade (50,000 sqm of office space) is due to be completed in H2 2023. Further out, Lot 6 Elizabeth Quay is expected to add 30,000 sqm in H2 2025.

### Net absorption

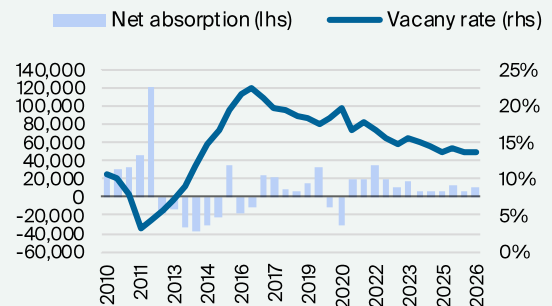
By grade, sqm



Source: Knight Frank Research, PCA

### Net absorption and vacancy rate

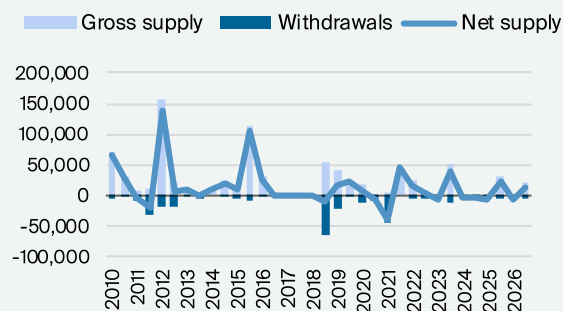
Sqm (lhs), percent (rhs)



Source: Knight Frank Research, PCA

### Supply and withdrawals

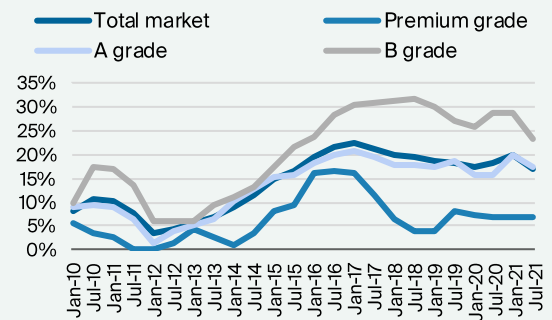
Sqm



Source: Knight Frank Research, PCA

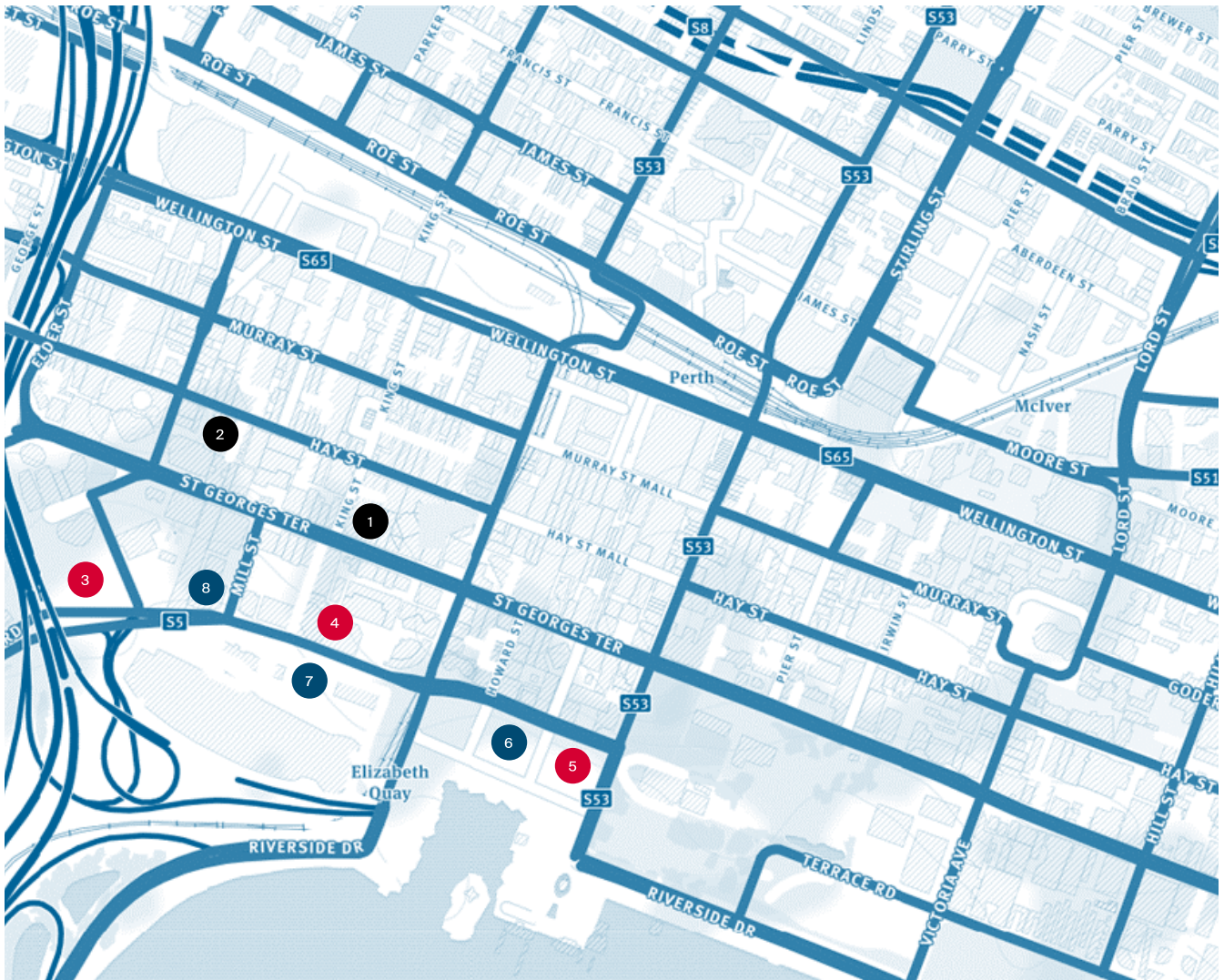
### Vacancy rate

By grade, percent



Source: Knight Frank Research, PCA

# MAJOR OFFICE SUPPLY



## MAJOR REFURBISHMENTS

- 1 THE ATRIUM (168-170 ST GEORGE'S TERRACE) – 12,500 SQM  
DRADGIN PTY LTD. H2 2021
- 2 DYNONS PLAZA (905 HAY STREET) - 13,200 SQM  
REDHILL PARTNERS. H1 2022

## UNDER CONSTRUCTION/ MAJOR PRE-COMMITMENT

- 3 CAPITAL SQUARE TOWER 2 (98 MOUNTS BAY ROAD) – 25,200 SQM  
[BDO AND WOODSIDE]  
AAIG MALAYSIA. H2 2021
- 4 WESTRALIA SQUARE 2 (141 ST GEORGES TERRACE) – 9,300 SQM
- 5 LOTS 7 & 8 ELIZABETH QUAY (ONE THE ESPLANADE) – 50,000 SQM [CHEVRON]

## DEVELOPMENT APPROVED

- 6 LOT 6 ELIZABETH QUAY – 30,000 SQM  
BROOKFIELD. H2 2025
- 7 PERTH CONVENTION CENTRE PRECINCT (21 MOUNTS BAY ROAD) – 20,000 SQM  
BROOKFIELD. H2 2026
- 8 1 MILL STREET – 45,000 SQM  
GDI/LENDLEASE. DATE TBC

# LOWER VACANCY TO UNDERPIN STRONGER RENTAL GROWTH

## Prime incentives have stabilised after rising sharply in 2020 while face rents edge higher

Prime net face rents rose by 0.9% over the six months to July to \$622/sqm to be 0.4% higher over the year. For the premium segment, face rents increased by 1% over the same period to \$672/sqm, 0.8% higher over the year. For the A grade segment, face rents rose by 0.7% over the six months to July to \$573/sqm, the same level as a year ago.

Average prime incentives remained unchanged in the July quarter at 49.6% but are still 1.25 percentage points higher than six months ago and 5.4 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.

Prime net effective rents rose by 0.4% in the three months to July to \$314/sqm but remain 1.6% lower than six months ago and 9.3% lower over the year.

In the secondary market, net face rents rose by 0.8% over the six months to July to be 2.1% lower over the year. Net effective rents increased by 0.3% over the same period and are 4.2% lower over the year. Average secondary incentives rose marginally to 53.3%.

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.

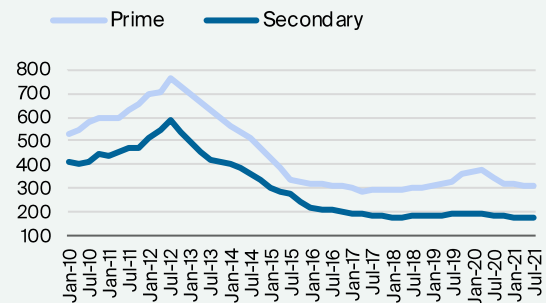
## Incentives to fall and rental growth to strengthen as vacancy declines

Reflecting stronger leasing market conditions, average incentives in the Perth CBD office market are expected to decline steadily from their current level of around 50%, leading to relatively rapid growth in effective rents.

Net effective rents are expected to grow by around 5% per annum over the next five years, a relatively strong growth rate compared to the other major capital city markets.

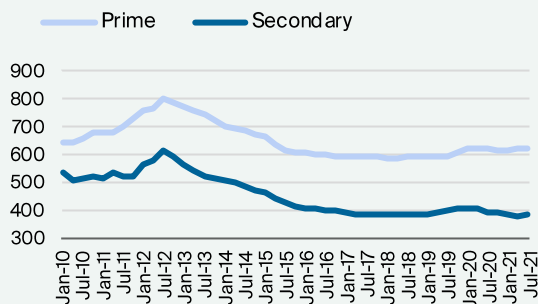
Growth in face rents is also likely to pick up. Prime net face rents are expected to grow by around 2% per annum over the next five years.

**Net effective rent**  
By grade, \$/sqm



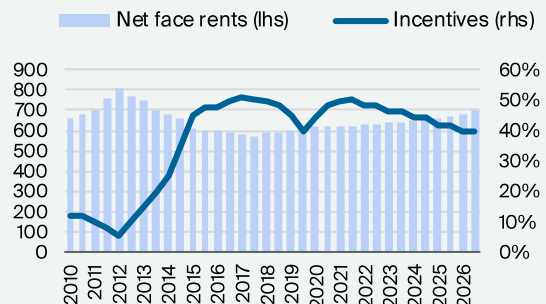
Source: Knight Frank Research

**Net face rent**  
By grade, \$/sqm



Source: Knight Frank Research

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



Source: Knight Frank Research

# INVESTORS EXPRESS CONFIDENCE IN PERTH

## Investment volume in 2021 over four times higher than in 2020

Investment in the Perth CBD has picked up strongly since late 2020 following the subdued level of activity seen at the onset of the pandemic. Investment volume has totalled \$841 million in 2021 to date, over four times higher than in 2020 and just 5% below 2019 levels. The increase largely reflects several major deals 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.

There are also several notable deals in the pipeline. Mirvac is looking to sell Allendale Square at 77 St Georges Terrace for \$250 million, while Peakstone has put 182 St Georges Terrace on the market.

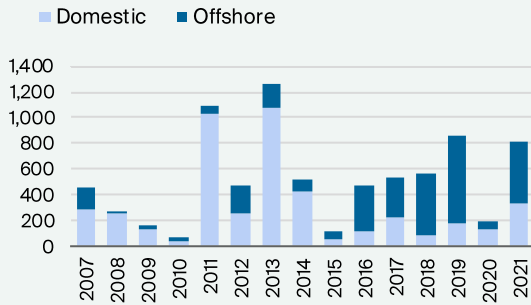
## Prime yields tighten reflecting strong investor interest in Perth

The average prime CBD office yield has tightened by 10 basis points over the past six months to 6.30%. The average premium and A grade yields both tightened by 10 basis points to 6.15% and 6.45% respectively, so the spread between premium and A grade yields remains unchanged at 29.2 basis points.

The prime yield spread to 10-year government bonds rose by 62 basis points over the same period mostly reflecting a 52 basis point rise in the government bond rate, while the spread to the average Sydney CBD prime office yield fell by 5 basis points to 197 basis points.

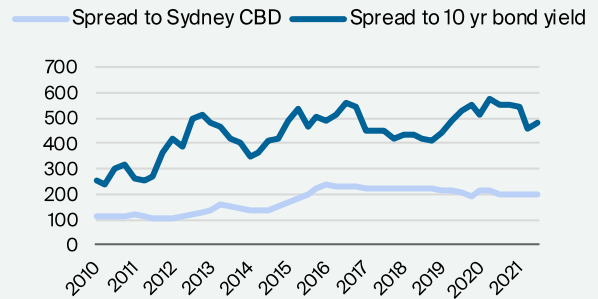
The average secondary CBD market yield remained unchanged over the six months to July at 7.40%. The spread between the average prime and secondary yield rose by 10 basis points to 110.4 basis points.

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



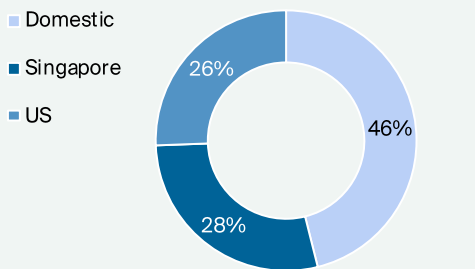
Source: Knight Frank Research

**Prime yield spread**  
Basis points



Source: Knight Frank Research

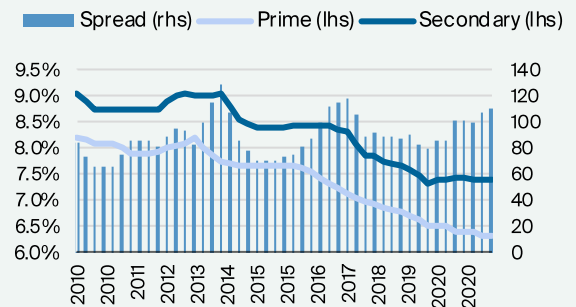
**Perth CBD office investment by country**  
2020 and 2021, transactions greater than \$10 million



Source: Knight Frank Research

**Yields**

Percent (lhs), basis points (rhs)



Source: Knight Frank Research

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Australian Industrial Review Q2 2021



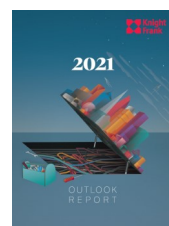
Urban Logistics July 2021



Australian Prime Residential Review Q2 2021



The Wealth Report 2021



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