RESEARCH

Knight Frank

SEPTEMBER 2013

PERTH CBD OFFICE

Market Overview

HIGHLIGHTS

- The total vacancy rate reported by the Property Council of Australia (PCA) was 6.9% as at July 2013, up from 4.2% a year ago. The biggest increase in total vacancy has been in Secondary-grade buildings with 9.5% of this stock vacant, up from 5.9% in July 2012.
- The first six months of 2013 saw net additions of only 8,441m². Knight Frank research forecasts the next major round of new supply to enter the market from 2015 onwards.
- There has been six major office transactions within the Perth CBD, totalling $1.31 billion in 2013 year to date. Prime and Secondary yields are above their 10 year averages of 7.65% and 8.79% respectively. Prime Grade core market yields range from 7.25% - 8.25%, whilst Secondary-grade core market yields are between 8.50% and 10.00%.

Table 1
Perth CBD Office Market Indicators as at July 2013

Grade	Total Stock (m^2)	Vacancy Rate (%)	Annual Net Absorption (m^2)	Annual Net Additions (m^2)	Average Net Face Rent ($/$m^2$)	Average Net Incentive (%)	Average Core Market Yield (%)
Prime	925,615	5.1	-16,422	2,512	686-804	15.0	7.25 – 8.25
Secondary	671,592	9.5	-14,414	10,563	504-543	20.0	8.50 – 10.0
Total	**1,597,207**	**6.9**	**-30,836**	**13,075**			

Source: Knight Frank/PCA

SUPPLY & DEVELOPMENT ACTIVITY

Gross supply in the Perth CBD remained relatively subdued during the first six months of 2013 with only 9,144m^2 of gross additions entering the market. As a result, total stock remained relatively static.

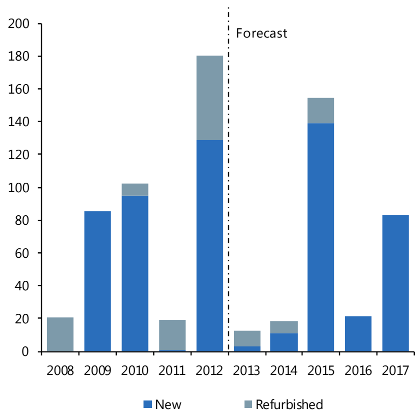
The entirety of this supply consisted of refurbishments within two buildings. 1 Mill Street (6,325m^2) was withdrawn from stock in 2012 to be fully refurbished, and 5 Mill Street (2,819m^2) was withdrawn in stages during the second-half of 2012 to also undergo refurbishments. Total stock withdrawals during the first half of 2013 totalled 703m^2.

Minimal stock additions are anticipated for the Perth CBD during the remainder of 2013. 1006 Hay Street, comprising 3,105m^2 of NLA, is the only new development under construction and due for completion this year. As a result, the expected total yearly gross supply for 2013 will be 12,249m^2. This is a 93.2% reduction from the record high gross additions, totalling 179,907m^2, experienced last year and 21.2% below the 20 year average.

In 2014 it is anticipated that 18,507m^2 of gross additions will become available in the latter part of the year. This is made up of a new development at 861 Hay Street adding 10,947m^2 of NLA, as well as 7,560m^2 at 565 Hay Street which is undergoing refurbishment.

The next major round of stock additions to hit the Perth CBD market will be in 2015. This includes a full refurbishment of Golden Square at 32 St Georges Terrace (15,045m^2), and new developments including the office tower within the Old Treasury Building Precinct (30,196m^2), Veil 253 at 253 St Georges Terrace (3,577m^2), 999 Hay Street (10,160m^2), Brookfield Place South at 123 St Georges Terrace (34,000m^2), KS1 at Kings Square (22,247m^2), KS2 at Kings Square (19,425m^2), KS3 at Kings Square (6,500m^2), and KS4 at Kings Square (13,000m^2).

Figure 1
Perth CBD Supply
('000m^2) Supply (new & refurb)



Source: Knight Frank/PCA

A new development at 47-59 Milligan Street, comprising 21,000m^2, has been granted a DA and is forecast to come online during 2016.

Subsequently, 83,000m^2 may reach the market in 2017 comprising 48,000m^2 being approved at 98-124 Mounts Bay Road (the former Emu Brewery) and 35,000m^2 is pending a DA at 480 Hay Street (owned by BGC Development).

Beyond this, around 113,719m^2 of mooted projects are in the pipeline, with a further 337,000m^2 of commercial space anticipated to come online in the longer term. Included within these major commercial developments are

- **Waterbank,** which is a 40 hectare site situated in East Perth on the banks of the Swan River
- **Elizabeth Quay**, which is around 10 hectares of prime riverfront land in the heart of the CBD, and
- **Perth City Link**, which is a 13.5 hectare site situated upon the recently sunken Perth City train line and will reconnect the CBD with Northbridge for the first time in 100 years.

GROSS SUPPLY FOR 2013 WILL BE WELL BELOW THE RECORD HIGH ADDITIONS OF 2012

MAJOR OFFICE SUPPLY

1. 1006 Hay Street - 3,105m²
   Private - Q3 2013 - 18% committed
2. 861 Hay Street - 10,947m² [Aurecon]
   Perth Diocese - Q3 2014 - 50% committed
3. 565 Hay Street - 7,560m² #
   Perth Diocese - Q4 2014 - seeking pre-commitment
4. Treasury Building - 30,196m² [WA Gov't]
   Mirvac / Keppel REIT consortium - March 2015 - 100% committed
5. 32 St Georges Tce - 15,045m² # [Legal Aid]
   Private - Q2 2015 - 40% committed
6. KS1 (Kings Square), 376 Wellington St - 22,247m²
   DEXUS & DWPF - mid 2015+ - seeking pre-commitment
7. KS2 (Kings Square), 376 Wellington St - 19,425m² [Shell]
   DEXUS & DWPF - mid 2015+ - 82% committed
8. KS3 (Kings Square), 376 Wellington St - 6,500m² [John Holland]
   DEXUS & DWPF - mid 2015+ - 100% pre-committ
9. 123 St Georges Tce (Brookfield Place Sth) - 34,000m² [Corrs, Deloitte, Brookfield] - Brookfield - Q3 2015 - 41% committed
10. 999 Hay Street - 10,160m² [GHD]
    QUBE - Q4 2015 - 59% committed
11. KS4 (Kings Square), Wellington St - 13,000m² [HBF]
    HBF - late 2015 - 69% committed
12. Veil 253, 253 St Georges Terrace - 3,577m²
    Primewest - Q4 2015 - DA Approved, seeking pre-commitment
13. 47-59 Milligan Street (Milligan Square) - 21,000m²
    Georgiou - mid 2016 - DA Approved - seeking pre-commitment
14. Capital Square, 98-124 Mounts Bay Rd - 48,000m²
    AAIG - Q2 2017 - DA Approved - seeking pre-commitment
15. Waterbank, near The Causeway - 17,000m²
    Lend Lease / MRA - Initial site works
16. Elizabeth Quay - 200,000m²
    Leighton / Broad Construction Services - Initial site works
17. Perth City Link - Circa 120,000m² exclusive of Kings Square
    Circa 220,000m² total office space - Initial site works
18. 100 Murray Street - 4,000m² #
    AWD Diversified - Mooted
19. 950 Hay St (old Melbourne Hotel site) - 11,219m²
    Oakesfield - DA Pending
20. 374-396 Murray St - 28,000m²
    Grocon - Mooted
21. 239 St Georges Tce (Bishops See no.2) - 30,000m²+
    Brookfield/Hawaiian - Mooted
22. KS5 (Kings Square) - 38,000m²
    Seven Entertainment - Mooted
23. 480 Hay Street - 35,000m²
    BGC - DA Pending
24. 36 St Georges Terrace - 16,500m²
    Uniting Church of Australia - DA Pending

Under Construction

DA Approved / Confirmed / Site Works

Mooted / Early Feasibility

NB. Dates are Knight Frank Research estimates
Major tenant precommitment in [brackets] next to NLA
Major refurbishment

Office NLA quoted

Map Source: PCA

TENANT DEMAND & RENTS

Property Council of Australia

The July 2013 release of data from the PCA saw the total vacancy rate for the Perth CBD increase to 6.9%, up from 5.7% in January 2013. Since July 2012, vacant space has increased by 43,911m^2 (up 65.6%) while total stock has only increased by 13,075m^2 (up 0.8%) and now sits at 1,597,207m^2.

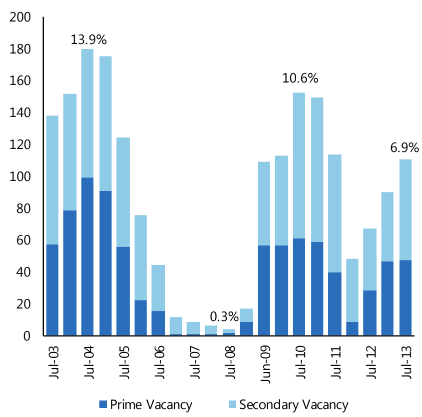
Table 2
PCA CBD Vacancy Rates (%)
July 2012 to July 2013

Grade	July 2012	Jan 2013	July 2013
Premium	1.3	4.5	2.7
A Grade	4.0	5.4	6.3
Prime	**3.1**	**5.1**	**5.1**
B Grade	5.8	6.2	9.4
C Grade	6.1	7.0	9.7
D Grade	1.0	9.0	9.0
Secondary	**5.9**	**6.5**	**9.5**
Total	**4.2**	**5.7**	**6.9**

Source: PCA

Secondary-grades have recorded the biggest increase in vacancy over the last six months, increasing to 9.5% or 63,708m^2.

Figure 2
Perth CBD Historical Vacancy
Prime and Secondary grade ('000's)



Source: PCA

Within the Secondary-grade, vacancy in B and C-grade buildings increased by 52% and 39% respectively. This rise is mostly attributable to company contraction resulting in sublease space entering the market which is now 2.5% of stock.

The Prime-grade vacancy remains at 5.1% or 47,105m^2. Within the Prime-grade, vacancy in Premium buildings decreased 38% while A-grade buildings experienced a 17% rise.

Net Absorption

Total net absorption for the twelve month period to July 2013 was -30,836m^2. This was made up of -18,332m^2 in the six months to January 2013, and -12,504m^2 in the six months to July 2013. This negative result was mostly a consequence of sub-lease space that became available in the market, as well as weakening demand from resources related companies. This has been particularly evident since September 2012 where the spot price for iron ore dipped by around 30% which impacted on business confidence and investment decisions.

Although -16,422m^2 of net absorption was recorded for Prime-grade space over the last year, Premium-grade experienced a positive reading of 5,507m^2 during the last six months showing signs of demand for higher quality space. As a result, the premium-grade vacancy level improved over the same period and currently sits at 2.7%. Slightly lower levels of negative demand were seen in the Secondary-grade market with -14,414m^2 of net absorption being recoded over the last twelve months. B-grade properties recoded their first negative result since the six months to July 2010.

Knight Frank anticipates that over the next six to twelve months, absorption will remain subdued in a flat market.

Backfill Space

No major backfill space has entered the market since 2012 when BHP moved into Brookfield Place, at 125 St Georges Terrace and Bankwest took up tenancy in Bankwest Place, 300 Murray Street.

Looking forward, limited backfill space is expected to enter the market over the next 12 months due to low levels of new supply being added. However, new development completions in late 2014 and 2015 will potentially see backfill space begin to impact the market. The close of 2014/early 2015 will see Aurecon's move to 861 Hay Street, with approximately 5,144m^2 of backfill space becoming available.

In mid-2015, Crown Law are expected to move into the Treasury Building at 54-58 Barrack Street and Legal Aid are expected to relocate to 32 St Georges Terrace making available 16,000m^2 and 4,000m^2 of backfill space respectively.

It is forecast that the end of 2015 will see another 16,000m^2 of backfill space enter the market with GHD moving into 999 Hay Street (4,000m^2 backfill), Shell moving into KS2 Kings Square (5,500m^2 backfill), and HBF (owner occupier) moving into KS4 Kings Square (6,500m^2 backfill).

Table 3
PCA CBD Total Vacancy (m^2)
July 2012 to July 2013

Grade	July 2012	Jan 2013	July 2013
Premium	4,192	14,364	8,857
A Grade	23,979	32,537	38,248
Prime	**28,171**	**46,973**	**47,105**
B Grade	25,932	28,029	43,418
C Grade	12,711	14,039	19,490
D Grade	88	800	800
Secondary	**38,731**	**42,931**	**63,708**
Total	**66,920**	**89,868**	**110,813**

Source: PCA

Anticipated Vacancy Levels

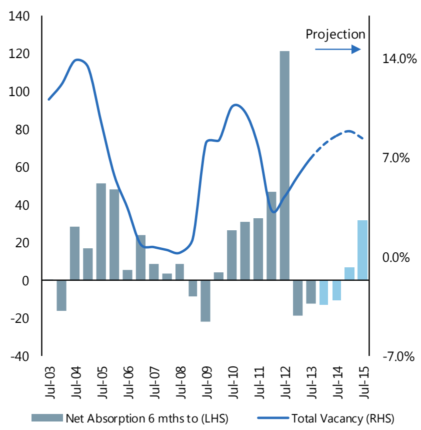
The increase in sub lease space currently sitting vacant in the market (2.5%) is impacting on total vacancy levels in the Perth CBD, having increased by over 19,000m^2 since July 2012. The majority of this increase, however, occurred in 2012 and was predominantly fuelled by mining and mining services tenants relinquishing space during bouts of company downsizing.

Over the last six months, however, sub lease space into the market (2,637m^2) decreased indicating that the majority of business adjustments have been made in response to economic conditions.

Figure 3

Net Absorption and Vacancy

('000's) per six month period



Source: PCA/Knight Frank

Looking forward, it is anticipated that absorption will remain flat to negative over the next six to twelve months, and as a result, PCA vacancy figures are expected to rise to circa 8.5% by July 2014. Furthermore, with 175,762m^2 of new supply forecast to enter the market by year end 2015, the vacancy is expected to rise further thereafter.

Knight Frank has calculated space actually available to lease, as at July 2013, is just above 8% of total stock. This figure is higher than the PCA figure for the same period as it incorporates space actively marketed for lease, though not yet vacant in the market.

Tenant Demand

The Perth CBD office market has experienced a considerable reduction in demand over the past 12 months as many resource based companies switched from rapid expansion to minimising costs. Concerns about the resources sector, however, have not caused CBD vacancy levels to blow-out completely.

The PCA has noted that negative demand for office space in the Perth CBD was -12,504m^2 since January 2013 which represents 41% of the annual figure.

A level of enquiry remains in the market for office space with companies generally seeking to upgrade their premises to newer, Prime-grade stock. Additionally, companies have continued to pre-commit to various new development projects within the Perth CBD. 93,390m^2 of pre-committed new supply is forecast to be occupied by 2015 year end.

Looking forward, it is anticipated that enquiry will increase during 2014 with a number of large leases nearing expiration.

Rental Levels

Rents have come under pressure over the past 12 months as market conditions have softened. Average net face rents have decreased 3.4%, from \$771/m^2 as at January 2013 to a current level of \$745/m^2. Net face rents for Secondary-grade properties are on average \$523/m^2.This is a decrease of 7.6% since July 2012, and is the lowest average Secondary-grade net face rent figure recorded since July 2011.

Incentives have experienced substantial growth over the past nine months. Prime-grade incentives, which sat at 5% in October 2012, now sit at 15%, and can be attributed to rising sub lease vacancy levels and softer demand. Larger increases in incentives have been felt in Secondary-grade properties, which now sit at circa 20%.

Knight Frank anticipates that incentives will remain high until late 2015 at which time vacancy levels will increase as new supply enters the market. Thereafter, incentives are expected to fall back to around 10%.

Table 4

Recent Leasing Activity Perth CBD

Address	Area (sq m)	Net Face Rental (\$/m^2)	Term (yrs)	Lease Type	Tenant	Start Date
250 St Georges Terrace (QV1)	28,480	875	7	New Lease	Chevron	Jan-17
861 Hay Street	5,144	650	10	New Lease	Aurecon	Jul-14
32 St Georges Terrace	5,725	Undisclosed	15	New Lease	Legal Aid	Mar-15
250 St Georges Terrace (QV1)	4,531	860	7	Renewal	Clayton Utz	Oct-13
250 St Georges Terrace (QV1)	6,119	875	10	Renewal	Freehills	Apr-13
200 St Georges Terrace	1,060	680	10	New Lease	Australian Electoral Commission	Mar-13
152 St Georges Terrace, Central Park	1,647	910	10	Undisclosed	Japan Australia Pty Ltd	Mar-13
66 St Georges Terrace	2,013	665	5	Renewal	Subsea 7	Mar-13
152 St Georges Terrace, Central Park	5,400	695	5	Sub Lease	INPEX	Jan-13

Source: Knight Frank

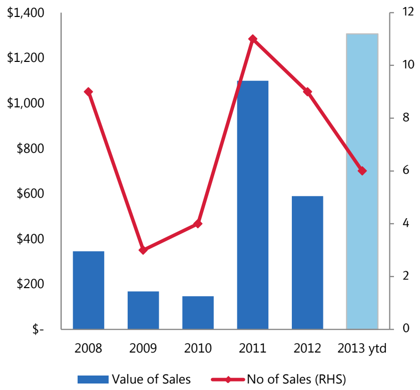
INVESTMENT ACTIVITY & YIELDS

Considerable transaction activity, totalling $1.31 billion, has occurred within the Perth CBD in the 2013 year to date. This is a substantial increase (122%) from the investment activity seen in 2012 which totalled $589.215 million. Interestingly, the 2013 year to date historically high value of sales consists of only six transactions, two of which are the highest Perth CBD office sales on record.

Figure 4

Perth CBD Sales Activity CY 2013

($ million) Sales Value >$10 million



Source: Knight Frank

The sale of KS1, 2 & 3, Kings Square, was one of the larger transactions seen this year totalling $434.8 million. The three office towers, which are currently under construction and due for completion in late 2015, were purchased by DEXUS Property Group Ltd and DEXUS Wholesale Property Fund (DWPF) and are currently 45% pre-committed by major tenants John Holland and Shell. The property forms part of Kings Square which is a subdivision of the former Perth Entertainment Centre site located along the northern side of Wellington Street, opposite Milligan Street, and at the western end of the new Perth City Link development. The sale represented a blended core market yield of 8.0%

KS4, which will also form part of the Kings Square precinct and is due for completion in late 2015, was sold in February this year to HBF House Pty Ltd for $97.89 million. HBF plan to relocate from their current address, at 125 Murray Street, to KS4 when it is completed, having already pre-committed to 9,000m^2 of NLA.

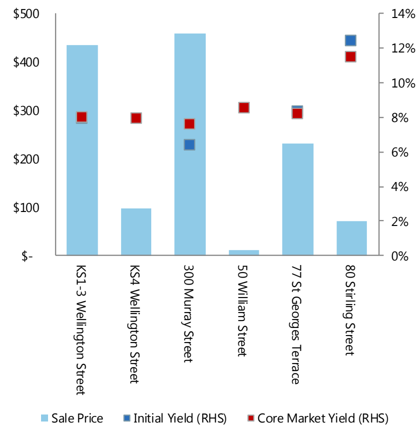
The largest Perth CBD transaction this year has been the acquisition of Raine Square and Bankwest Place at 300 Murray Street. Charter Hall formed a partnership with its Core Plus Office Fund (CPOF), Telstra Super and Canadian pension fund PSP to purchase the commercial/retail complex for $458 million which represented a core market yield of 7.6%. The 22 storey, Premium-grade Bankwest Place has been fully leased by the Bank of Western Australia Ltd for an initial term of 12 years. At the time of the sale the weighted average lease expiry was 9.5 years.

In addition, Allendale Square, at 77 St Georges Terrace, sold in June this year to Mirvac Group, as part of a GE portfolio sale, for $231 million representing a core market yield of 8.2% At the time of the sale, the 34 level, A-grade office tower had a vacancy of 4.6% (1,107m^2) and a WALE of 6.7 years.

Figure 5

Major 2013 CBD Sales and Yields

($ million) Sales value >$10 million



Source: Knight Frank

Table 5

Major Office Sales Activity 2013 Perth CBD

Address	Price ($ mil)	Core Market Yield (%)	NLA (m^2)	$/m^2 NLA	Vendor	Purchaser	Sale Date
80 Stirling Street	72.15	11.47	19,775	3,649	Australian Unity	CorVal Partners	Jun-13
77 St Georges Terrace	231.00	8.20	28,123	8,214	GE Real Estate Investments Australia Pty Ltd	Mirvac Group	Jun-13
300 Murray Street, Raine Square/Bankwest Place	458.00	7.60	61,490	7,448	Westgem Investments Pty Ltd (Receivership)	Charter Hall's CPOF, Telstra Super & PSP	Apr-13
50 William Street	12.15	8.50	2,637	4,608	R & I Bank of Western Australia	Silverleaf Investments Pty Ltd	Mar-13
KS4, Kings Square	97.89	7.90	13,305	7,357	Seven Entertainment Pty Ltd	HBF House Pty Ltd	Feb-13
KS1, 2 & 3, Kings Square	434.80	8.00	52,781	8,239	Seven Entertainment Pty Ltd	DEXUS Property Group & DWPF	Feb-13

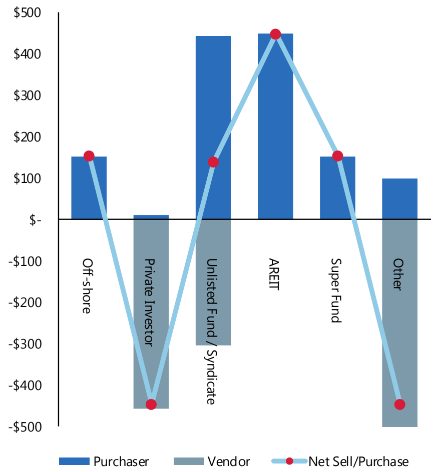
Source: Knight Frank

Core Market Yield: the percentage return/yield analysed when the assessed fully leased market income is divided by the adopted value/price which has been adjusted to account for property specific issues (i.e. rental revisions, rental downtime for imminent expiries, capital expenditure, current vacancies, incentives, etc)

Domestic groups have been the dominant purchasers over the past year, driven by acquisitions by Mirvac, DEXUS and Charter Hall.

The only offshore investment recorded in 2013 year to date, consists of Canadian pension fund, PSP's, 33% share in the acquisition of Raine Square and Bankwest Place at 300 Murray Street. Since the acquisition of 300 Murray Street in April 2013, the Australian dollar has weakened from a fairly sustained period above parity, to currently sit at circa AUD/USD 0.89. As a result, interest from offshore investors has increased within the Perth office market over the last three months.

Figure 6
Perth CBD Purchaser / Vendor 2013 ytd
($ million) Sales Revenue >$10 million



Source: Knight Frank

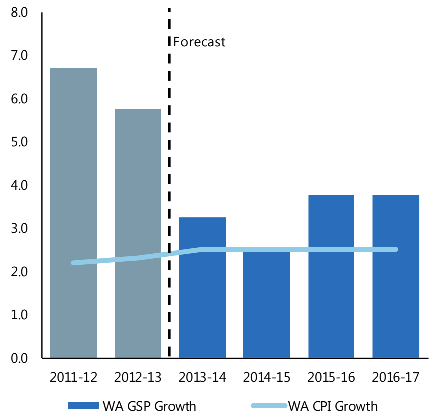
Prime-grade core market yields have broadened over the last six months ranging from 7.25% to 8.25%. The sale of Raine Square and Bankwest Place, however, reflected a passing yield of 6.4% which not only fell substantially lower than its core market yield of 7.6%, but also the yield range. This is indicative of the quality of this property being a modern building with very little capex requirement in the short to medium term. In addition, the building has a lengthy weighted average lease expiry in the office component with Bankwest on a 12 year lease due to expire in February 2024, who provide almost 70% of the total income at rents well below market. Given that the core market yield is above the passing yield, is an indication that there is potential for rental growth in the future.

OUTLOOK

Forecasts from the Department of Treasury indicate that the West Australian economy will grow by 3.25% in 2013-14. This is the highest growth rate anticipated for any Australian state this year and 0.75% above the national growth forecast.

The West Australian mining industry is now entering a new phase. Resource sector investment and spending is forecast to decline while the volume of commodities being exported is expected to rise. Iron ore exports have already begun to rise in 2013, with volumes forecast to increase by circa 15% per annum going forward. The increases in iron ore exports are expected to remain at high levels for some time.

Figure 7
West Australian Gross State Product
(%) vs West Australian Consumer Price Index



Source: Knight Frank/Department of Treasury

Natural gas exports are unlikely to experience strong growth until 2015. Thereafter, natural gas exports are expected to experience several years of very strong growth and then remain high for a few decades. Higher volumes of commodity exports should see real GDP increase, and as a result, a rise in national income, however, this rise will be slightly offset by lower commodity prices.

Confidence within the Australian business community has been dampened and remains subdued. This is primarily due to the current international outlook, the phase shift of the mining boom, and the uncertainty surrounding future government policy given the upcoming federal election. Consequently, structural changes have occurred within many businesses that occupy office space in the Perth CBD and fringe areas. This has caused vacancy within the Perth CBD to increase, resulting in declining average net face rents and rising incentives.

Prime-grade net face rents are expected to ease further over the next twelve months, while it is anticipated that Secondary-grade net face rents remain relatively flat.

Both Prime and Secondary-grade yields experienced little movement over the last six months, however, averaging 8.0% and 9.25% respectively, they continue to be confined to the upper end of their long term averages.

With the formalisation of the next round of construction expected to come online in 2015, the Perth CBD office market is somewhat exposed to further downside risk. As this space is not available for another 12 to 18 months, the rise in vacancy will not be significant in the short term. Vacancy levels thereafter are expected to increase more sharply, potentially over 10% by the end of 2015.

In contrast to the relative weakness in the leasing market, investment demand has been, and is expected to remain fairly robust. This is indicative of the six major Perth CBD office transactions which were finalised during the first six months of 2013. With a weaker Australian dollar and historically low interest rates, it is expected that overseas investment will increase, along with interest from local institutions.

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