RESEARCH

PARRAMATTA

OFFICE MARKET BRIEF MARCH 2018

Key Facts

As at January 2018, Parramatta's overall vacancy rate recorded 3.0%, driven by strong absorption in the secondary market.

Over 100,000 sq m of stock is currently under construction, which has all been pre-committed; this is anticipated to push vacancy down towards 2%.

Significant rental growth has been underpinned by limited stock, increasing prime gross face rents by 8.5% YoY.

Total transaction volumes in the 12 months to January 2018 totals $411 million, more than double the previous year.

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Strong absorption levels in the secondary market coupled with no new speculative stock has driven vacancy down to 3%, thus resulting in record rental growth across the prime and secondary markets.

Strong absorption levels

Following the negative absorption of 212 sq m in the first half of 2017, the Parramatta market bounced back with one of its stronger periods of absorption to record 7,751 sq m over the six months to January 2018. With no available space in the prime market and strong tenant demand, all take up was recorded in the secondary market.

Government and small private sector tenants have driven the take up in the market. Notable deals include Vision Australia (1,270 sq m) and Legal Aid (900 sq m) at 128 Marsden Street, iCare (GPNSW) leasing 2,900 sq m at 56 station Street, and Frank Law (259 sq m) at 80 George Street. Absorption levels will increase over the first half of 2018 following the Department of Education moving into its new 25,000 sq m building at 105 Phillip Street.

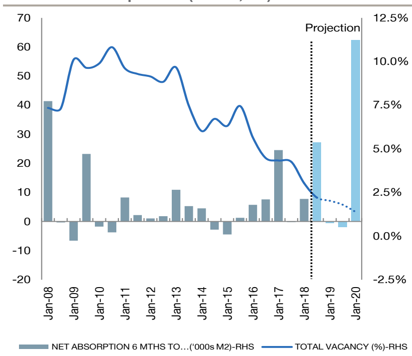
Record low vacancy

Following strong absorption and no new stock the Parramatta vacancy rate has fallen to 3% as at January 2018, down from 4.3% six months prior. The vacancy rate remains well below the 10 year average of 7.5% and is at its lowest point since the series began in 1990.
Demand pressure from the Sydney CBD and supply drought has been the catalyst for the falling vacancy rate.

FIGURE 1

Net Absorption and Vacancy

Per six month period (000's, %)



Source: Knight Frank Research/PCA

No availability in the prime market

Split by grade, the prime market has no available space, a figure which has remained consistent since January 2016, making Parramatta the tightest prime office market in the country. With no speculative prime developments currently under construction the prime vacancy rate is expected to stay around zero for at least the next twelve months.

Additionally, CBA has delayed its vacation of 101 and 150 George Street until 2021 which suggests the pressure on the prime market is unlikely to ease in the short term. The secondary market experienced a significant decline in vacancy from 7.4% to 5.3% as at January 2018. With no available options In the prime market, tenants have been forced to seek space in the secondary market.

Looking forward, there remains strong tenant enquiry for the Parramatta market with several large market briefs considering options; including IAG for (7,000 sq m), iCare (10,000 sq m) and Link Marketing (20,000 sq m).

Accelerated rental growth across the board

Parramatta's tightening vacancy rate continues to drive face rental growth in both the prime and secondary markets.

The average prime gross face rent recorded its largest annual increase in Knight Frank's records of 8.5% to $629/sq m ($515/sq m net). While prime net incentives have remained steady at 18%-20% and they are anticipated to tighten over the next twelve months as owners are expected to capitalise on the favourable market conditions.

In the secondary market gross face rents have seen even stronger growth than prime rents with an annual increase of 10.5% to $536/sq m ($419/sq m net). Additionally, secondary incentives have declined to around 20%-21% from 22%-23% a year ago, boosting the gross effective rental growth to 13.2% YoY.

Limited speculative stock in pipeline

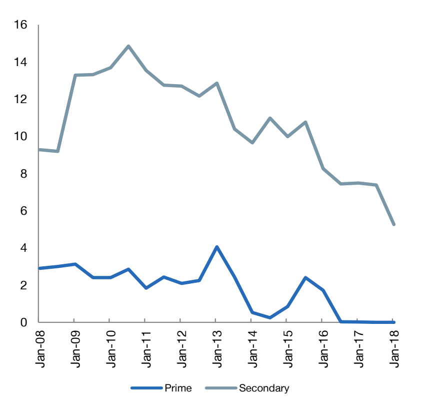
The next wave of supply for Parramatta, whilst all pre-committed will stem from Charter Hall's 105 Phillip Street (25,000 sq m) due to be occupied imminently by the Department of Education relocating from the Sydney CBD. in the Parramatta Square precinct construction is progressing with 4PSQ (63,000 sq m – 100% pre-leased to the NSW Government) and 3PSQ (42,000 sq m - fully committed to NAB) due for completion in late 2019 and 2020 respectively. Whilst gross supply is set to increase there are no speculative developments currently under construction.

Looking further ahead, Parramatta Council has recently given planning approval for GPT's commercial site at 32 Smith Street. The $230 million office tower will comprise over 26,000 sq m of prime office space and is currently seeking pre-commitments, with construction mooted for later this year. Additionally, Coombes Property Group and Drivas have lodged a development application for property circa 32,000 sqm office building at 50 Macquarie Street .

Potential to be second largest CBD market

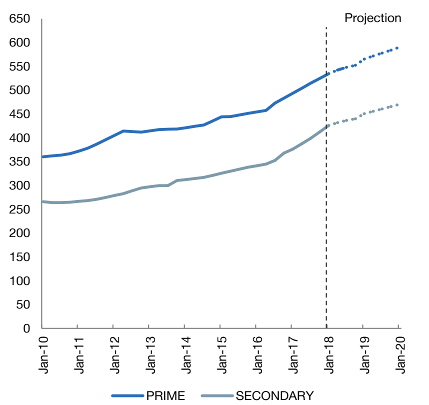
In total, there is over 600,000 sq m of new office projects in the pipeline. Whilst it is unlikely that all schemes will progress in the current development cycle, these may progress on the back of the rapid population growth in Western Sydney and supply shortages in other major CBD markets. In the coming years the Parramatta CBD is likely to overtake North Sydney in market size and potentially Macquarie Park in the next decade.

FIGURE 2
Parramatta Vacancy
Total vacancy by grade (%)



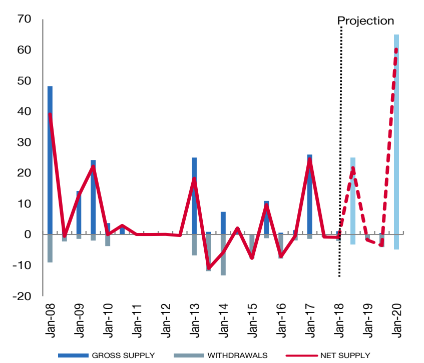
Source: Knight Frank Research/PCA

FIGURE 3
Average Gross Effective Rent
Parramatta ($/sq m)



Source: Knight Frank Research

FIGURE 4
Parramatta office Supply
Per six month period (000' sq m)



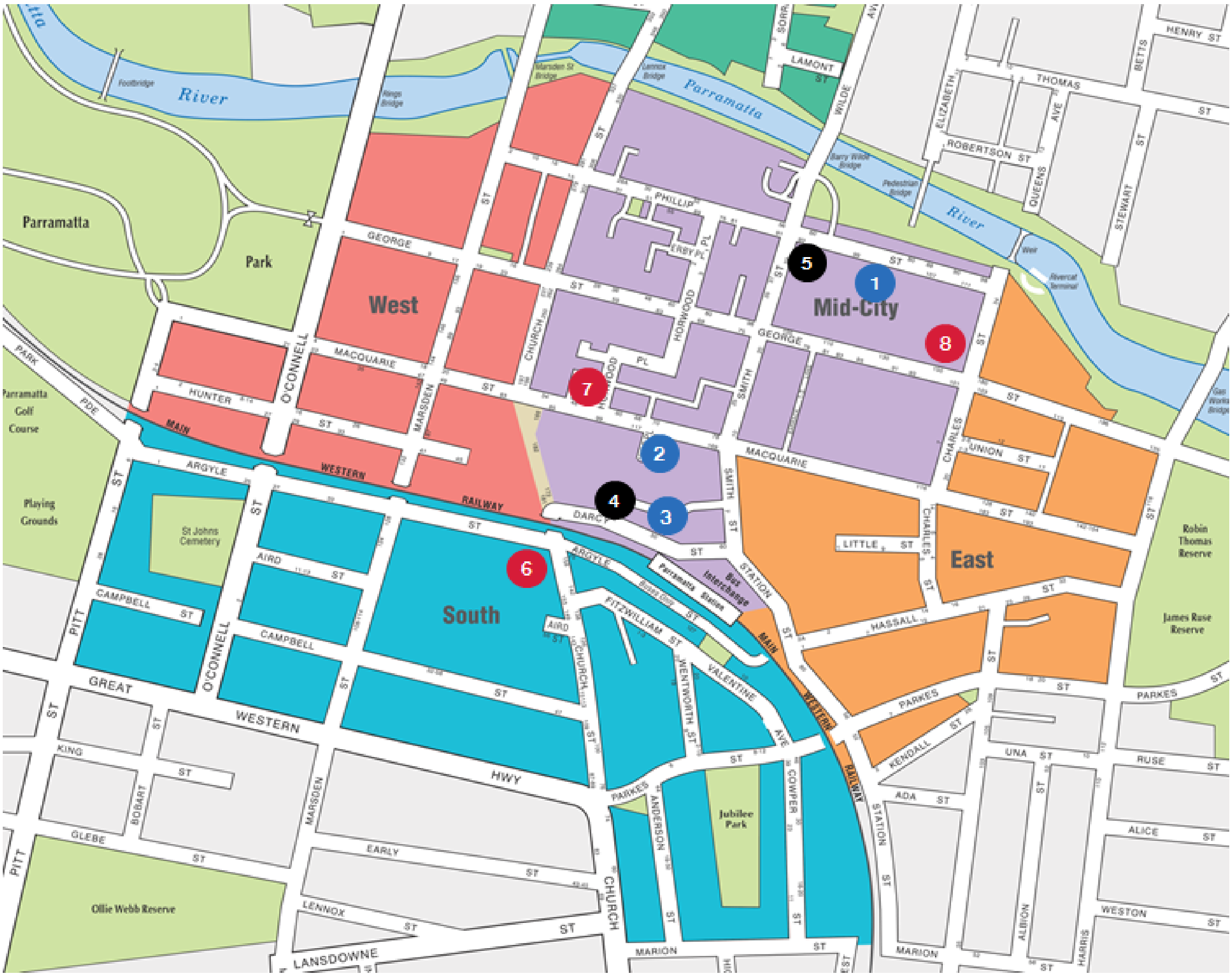
Source: Knight Frank Research/PCA

TABLE 1
Parramatta Office Market Indicators as at January 2018

Grade	Total Stock (sq m)	Vacancy Rate (%)	Annual Net Absorption (sq m)	Annual Net Additions (sq m)	Average Gross Face Rent ($/sq m)	Outgoings ($/sq m)	Average Net Incentive (%)	Average Core Market Yield (%)^
Prime	299,617	0.0	70	0	629	114	18.4	5.25 - 6.50
Secondary	405,799	5.3	7,469	-1,683	536	118	20.6	5.75 - 7.25
Total	**706,332**	**3.0**	**7,539**	**-1,683**	**576**			

Source: Knight Frank Research/PCA   ^ Based on an assumed 5 year WALE

MAJOR OFFICE SUPPLY



Source of map: Knight Frank

1 — 105 Phillip St - 25,000m² [NSW Department of Education]
Charter Hall - March 2018 - 100% committed

2 — 153 Macquarie St (Parramatta Square Stage 3)^ - 43,000m² [NAB]
Walker Corporation - Mid 2020

3 — Parramatta Sq. Stage 4^ - 65,000m² [NSW Government]
Walker Corporation - Mid 2019

4 — Parramatta Sq. Stage 6^ - 50,000m²+
Walker Corporation - 2021+

5 — 32 Smith St - 26,000m² - DA Approved
GPT - 2021

6 — Westfield, 159 Church St - 35,000m² #
Scentre Group - 2020+

7 — Greenway Plaza - 30,000m²
Coombes Drivas - 2021+

8 — 140 George Street - 45,000m²
Dexus -2021+

Under Construction/Complete

DA Approved / Confirmed / Site Works

Mooted / Early Feasibility

NB. Dates are Knight Frank Research estimates
Includes select major office supply (NLA quoted)
Major tenant pre-commitment in [brackets] next to NLA
^ Part of Parramatta Square project
# Westfield has applied to increase area to 110,000m²

Rising demand by institutional investors

The Parramatta office market has experienced strong investment activity over the 12 months to January 2018 with six transactions ($10m+) totaling $441 million, more than double the amount during 2017. Notably, the increase in sales volumes has been largely underpinned by the increased engagement of institutional investors in the Parramatta market. Large local institutions including GPT, Charter Hall and Mirvac have all made acquisitions through their unlisted funds or A-REITs.

Unlisted funds and syndicates accounted for 48% of the total volume of sales over the year or $293 million, registering 185% YoY growth. The increase in activity was bolstered by the acquisition of 105 Phillip Street by Charter Hall's Prime Office Fund (CPOF) and Direct Office Fund (DOF) for $229 million from Dexus. The asset, fully leased to the Department of Education on a 12 year WALE over 25,000 sq m, sold on a core market yield of 5.31%. This was the tightest yield ever recorded in Parramatta, surpassing the sale of the Parramatta Justice Precinct in 2014 (6.27% core market yield).

The strong purchasing activity by AREITs last year has stemmed from two transactions, both for redevelopment, with a total transaction volume of $118 million, a massive uplift from $6 million in the prior year. This has reaffirmed the increased appetite of institutional owners in the Parramatta market, which has been traditionally dominated by private investors. Making up the transaction number last year by AREITs was GPT Group purchasing the Salvation Army office buildings at 32 Smith Street for $31.2 million for redevelopment.

The sale represents a land rate per potential GFA of circa $1,200 sq m. Another highlight deal Mirvac acquiring 75 George Street for $86.3 million from Corval. The deal was struck at an initial passing yield of 5.51%.

Looking forward, the increasingly institutionalisation of ownership in Parramatta coupled with a solid pipeline of new quality stock will de-risk the market and reinforce Parramatta's profile as an attractive investment destination for both local and offshore investors.

Further pressure on yields for quality assets.

Investment yields have continued to compress in both the primary and secondary markets over the past six months. Average prime yields have compressed by circa 42bps in the past six months to circa 5.75-6.00% as at January 2018. In the secondary market, yields have declined by circa 47bps to range between 6.00% and 6.75%. Despite yields reaching the lowest levels ever recorded, Parramatta continue to maintain relative pricing advantage over Sydney CBD and lower North Shore commercial precincts.

TABLE 2

Recent Leasing Activity Parramatta

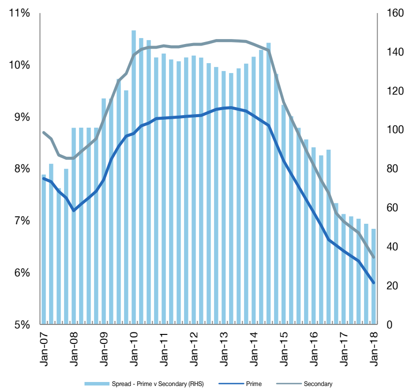
Address	NLA (m^2)	Face Rental ($/$m^2$)	Term yrs	Lease Type	Tenant	Date
9 George Street	850	$440N	8	New	Property NSW	Aug-18
110 George Street	937	$515N	5+5	New	TAFE	Apr-18
105 Phillip Street	25,230	$475N	12	New	Dept of Education	Mar-18
3 Horwood Place	290	$460N	3	New	Marsh	Feb-18
7 Hassall Street	943	$429N	2	New	Diverse Legal Services	Jan-18
128 Marsden Street	1,270	$325N	5+5	New	Vision Australia	Oct-17

Source: Knight Frank Research   n refers net   g refers gross

FIGURE 5

Average Core Market Yields

Parramatta Yield (LHS) and Spread bps (RHS)



Source: Knight Frank Research

TABLE 3

Recent Sales Activity Parramatta ($10m+)

Address	Price ($ mil)	Core Mkt Yield (%)	NLA (sq m)	$/sq m NLA	WALE (yrs)	Vendor	Purchaser	Sale Date
75 George Street	86.3	5.51	9,568	9,020	3	CorVal	Mirvac	Nov-17
128 Marsden Street	26.0	6.35	4,256	6,109	4.5		Private	Oct-17
426 Church Street	30.0	N/A	3,244	9,248	1.5	Unison Pty Ltd	Salvation Army	Jul-17
105 Phillip Street	229.0	5.31>	25,228	9,077	12	Dexus	Charter Hall POF	May-17

Source: Knight Frank Research

Outlook

- The overall vacancy rate in Parramatta is expected to remain at extremely low levels over the next two years despite the delivery of 90,000 sq m across 105 Phillip Street and 3PSQ, since both buildings are fully committed by the NSW Government and NAB relocating from other markets. This will see the overall vacancy rate in Parramatta trending down further by the end of 2019.

- Government tenants will continue to dominate the large space enquiry across the market with the Department of Transport, OSR, Department of Planning and Department of Industry all seeking to consolidate offices in the Parramatta CBD.

- Additionally, with large corporations, including NAB and PwC committing to space in Parramatta, whilst Allianz and Westpac are seeking new accommodation, we expect to see further corporate tenant engagement in the coming years as Parramatta enhances its corporate appeal with more prime stock becoming available.

- Prime gross face rents are forecast to increase at an average growth rate of 4.75% p.a. over the next two years and prime incentives are expected to fall below 18% by the end of 2019.

- In the secondary market, a similar growth rate of circa 4.75% pa is expected over the next two years, but refurbished secondary spaces could potentially yield higher growth. At the same time, secondary incentives are set to decrease to circa 20%.

- Investment interest from both local and offshore groups is expected to intensify due to compelling growth story and attractive pricing proposition relative to Sydney CBD and lower North Shore. Nevertheless, transaction activity remains constrained by the lack of tradable stock, as existing owners are reluctant to sell which further increases the pend up demand for investment opportunities.

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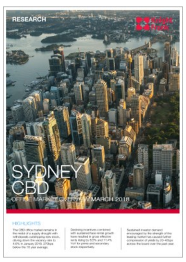

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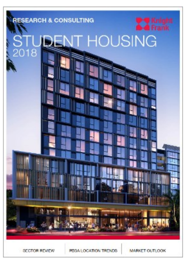

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