PARRAMATTA

OFFICE MARKET BRIEF SEPTEMBER 2019

Key Facts

Over 280,000 sq m of stock is currently under construction, of which 70% has been pre-committed; this is anticipated to keep vacancy tight.

No new supply and positive tenant demand has resulted in overall vacancy tightening from 3.0% to 2.7% in the six months to July 2019.

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Development activity reflects underlying confidence

The high volume of development activity underway in Parramatta is helping to strengthen the city's position as an emerging CBD centre, with a diverse range of businesses, including Government, expanding their office footprint to include Parramatta.

Competitive yield pricing

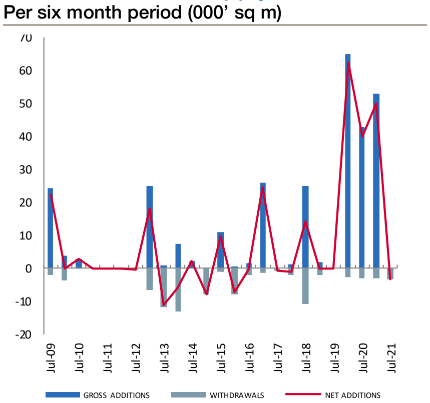
The mix of commercial office, health and education facilities being developed, together with the game-changing infrastructure projects, is also helping to attract more investors, elevating investment volumes to above-average levels and driving prime office yields to a record-low of 5.6%, down almost 200bps over the last two years. Despite this heady yield compression, assets are trading below values in Sydney CBD and this remains particularly attractive to investors.

Office demand sustains low vacancy outlook

Strong leasing fundamentals, underpinned by ongoing tenant demand for prime office space in Parramatta, has driven up pre-commitment levels on incoming new supply to more than 70% and put downward pressure on vacancy, prolonging the rental growth cycle.

With no new supply over the period, the headline vacancy rate has tightened from 3.0% to 2.7% in the six months to July 2019. The prime market vacancy rate remains one of the lowest in the country measuring 0.6% as at July 2019, while secondary vacancy declined by 40bps to 4.5% over the same period.

FIGURE 1
Parramatta office Supply
Per six month period (000' sq m)



Source: Knight Frank Research/PCA

Low vacancy fuels rental growth across the board

The underlying demand fundamentals for Parramatta, including the limited availability of prime leasing options in existing supply and strong take-up of development stock has resulted in a tightening of vacancy and put upward pressure on rental values, resulting in YoY rental growth rates above competing markets.

Average prime gross face rents have increased by 8% YoY to $701/sq m ($582/sq m net face) as at July 2019, well above the 10 year average annual growth rate of 4.8%. Prime incentives have remained steady over the last 12 months to average around 18%, resulting in gross effective rental growth of 8%.

In the secondary market, although the record double digit growth rates experienced in early 2018 have now eased, they remain above the historical average. In the 12 months to July 2019 secondary gross rents have increased by 5.8% to $591/sq m ($475/sq m net). Additionally, secondary incentives have declined 160bps to 18.9%, boosting gross effective rental growth 8% YoY.

Looking ahead, above trend rental growth rates are forecast to continue in the near-term as availability remains tight and Parramatta's transformation takes place, improving its attractiveness for occupiers.

Nevertheless, a slight uptick in vacancy over the first half of 2020 is anticipated, mainly as a result of the government relocations from secondary stock into their new hub in Parramatta Square.

Developments nearing completion

Walker Corporation's Parramatta Square Stage 4 is due for completion later this year and will welcome NSW Government across its 65,000 sq m of premium office space in 2019/2020. Stage 3, due for completion by mid-2020, will house NAB. This will result in 108,000 sq m of new supply being added to Parramatta in a single year, its highest on record and a 14% increase of its office stock base to reach approximately 820,000 sq m.

The final two Walker developments of Parramatta Square (Stages 6 and 8) have recently commenced construction to deliver a combined c120,000 sq m of office space. Property NSW has committed to 43,800 sq m, whilst Link Market Services has secured c20,000 sq m to consolidate their current Rhodes and Sydney CBD offices into one location.

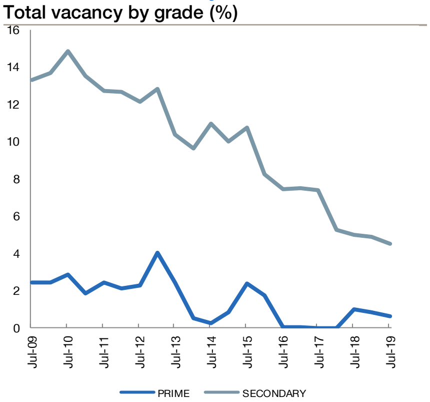
Other key developments include Charter Hall's 2-6 Hassall Street (27,000 sq m) and GPT's 32 Smith Street (26,000 sq m). Charter Hall is developing the Engineering Innovation Hub at Hassall Street with partner WSU, who have pre-committed to 40% of the development with UNSW, with completion expected in Q3 2021. Meanwhile, 32 Smith Street has been 51% pre-committed to QBE and due for completion in late 2020.

Absorption levels set to soar, underpinned by expansion demand

The Parramatta office market is characterised by competitive industry, including finance and insurance, education, professional services and government. There has been significant expansion from these sectors over the last five years, particularly NSW government under its decentralisation policy, which will see its office footprint in Parramatta expand from c150,000 sq m to over 250,000 sq m by 2022.

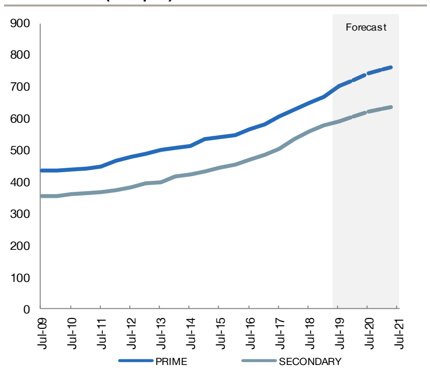
Over the next 12-18 months Parramatta is forecast to absorb more than 100,000 sq m of office space on the back of the NAB, NSW Government and University pre-commitments. However, the QBE pre-commitment at 32 Smith Street will result in 10,000 sq m of backfill space at 60 Station Street once they relocate. With strong tenant enquiry and large market briefs including Samsung (13,000 sq m), Westpac (10,000 sq m) and Commonwealth Government's, Department of Defence (up to 20,000 sq m), this space has the potential to be readily absorbed by the market.

FIGURE 2
Parramatta Vacancy
Total vacancy by grade (%)



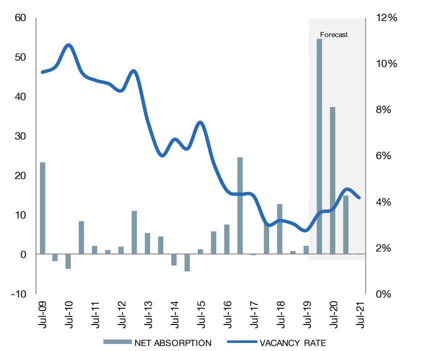
Source: Knight Frank Research/PCA

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



Source: Knight Frank Research

FIGURE 4
Net Absorption and Vacancy
Per six month period (000's, %)



Source: Knight Frank Research/PCA

TABLE 1
Parramatta Office Market Indicators as at July 2019

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	324,617	0.6	1,421	0	701	119	18.0	5.25 - 6.25
Secondary	394,930	4.5	1,596	-72	591	116	18.9	5.50 - 6.50
Total	**719,547**	**2.7**	**3,017**	**-72**				

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

Tight vacancy to continue

It is estimated that 70% of the c280,000 sq m currently under construction has been pre-committed. In addition to a number of existing large tenant mandates, current demand levels are strong, and this suggests that pre-leasing levels on this new supply could reach 100% prior to practical completion.

Strong investment activity to finish off 2019

Following robust investment activity in the second half of 2018, which saw $469.8 million transact across six assets including GPTs acquisition of 60 Station Street, there have been no major office transactions thus far in 2019. The limited activity in the first half of 2019 is indicative of the tightly held nature of Parramatta. The second half of 2019, however, is set for a strong finish and looks set to eclipse transaction volumes seen in late 2018 following two major assets on the market for sale.

Jessie Street Centre, currently Parramatta's largest office asset comprising over 53,000 sq m of NLA, is being sold by Brookfield with a price expectation of more than $400 million. The asset was put up for sale in April with 99.9% occupancy and a 4.5 year WALE. If sold, this would represent Parramatta's highest value transaction on record, further reinforcing investor long-term confidence in the market.

80 George Street has also been put on market by its Chinese owner after acquiring the asset in late 2016 for $51.88 million. The asset has undergone extensive capital expenditure works and its major tenant Westpac has extended terms positioning the asset with an attractive 5 year WALE. With the strong rental growth in Parramatta over the last couple of years, price expectations for this asset are around $80 million. The potential sale price would represent a capital value increase of over 55%, highlighting the strength of the market.

Looking forward, the increasing institutionalisation of ownership in Parramatta, coupled with a solid pipeline of new quality stock and improved infrastructure, will help reinforce Parramatta's profile as an attractive investment destination for both local and offshore investors.

Yield compression

Assets continue to trade below historical yield trends, reflective of the strong rental growth profile in conjunction with its relative yield value to the Sydney CBD market. Additionally, the unprecedent private and public sector development in Parramatta, which is improving connectivity to other strategic centres, has fuelled investor confidence.

Average prime yields have compressed by circa 12bps in the past 12 months to average between 5.50-6.00% as at July 2019. In the secondary market, yield compression has outpaced the prime market, indicative of secondary assets trading with future redevelopment potential and rental reversion upside. Secondary yields declined by 17bps YoY to range between 5.75% and 6.25%.

Despite large yield compression recently, there remains a 108bps positive yield arbitrage between Parramatta and the Sydney CBD market, providing an attractive pricing spread for investors. While there has been a noticeable shift in demand towards prime quality buildings to satisfy jobs demand in Parramatta, strong rental growth is expected to continue providing favourable conditions for investors. Additionally, with interest rates being cut by 50bps and further cuts anticipated in conjunction with low bond rates, there remains a strong case for further yield compression to impact the Parramatta market in the foreseeable future.

TABLE 2

Recent Leasing Activity Parramatta

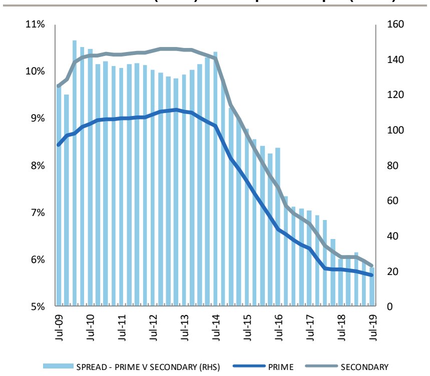
Address	NLA (m²)	Face Rental ($/m²)	Term yrs	Lease Type	Tenant	Lease start date
32 Smith Street	13,600	655n	10	Pre-comm	QBE	Dec-20
4PSQ	448	620n	5	Pre-comm	GT Insurance	Dec-19
126 Church Street	6,300	450n	3	Renewal	Parramatta Council	Nov-19
91 Phillip Street	1,445	525n	5	Renewal	Regus	Jul-19
80 George Street	175	490n	3	New	Urbis	Feb-19

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

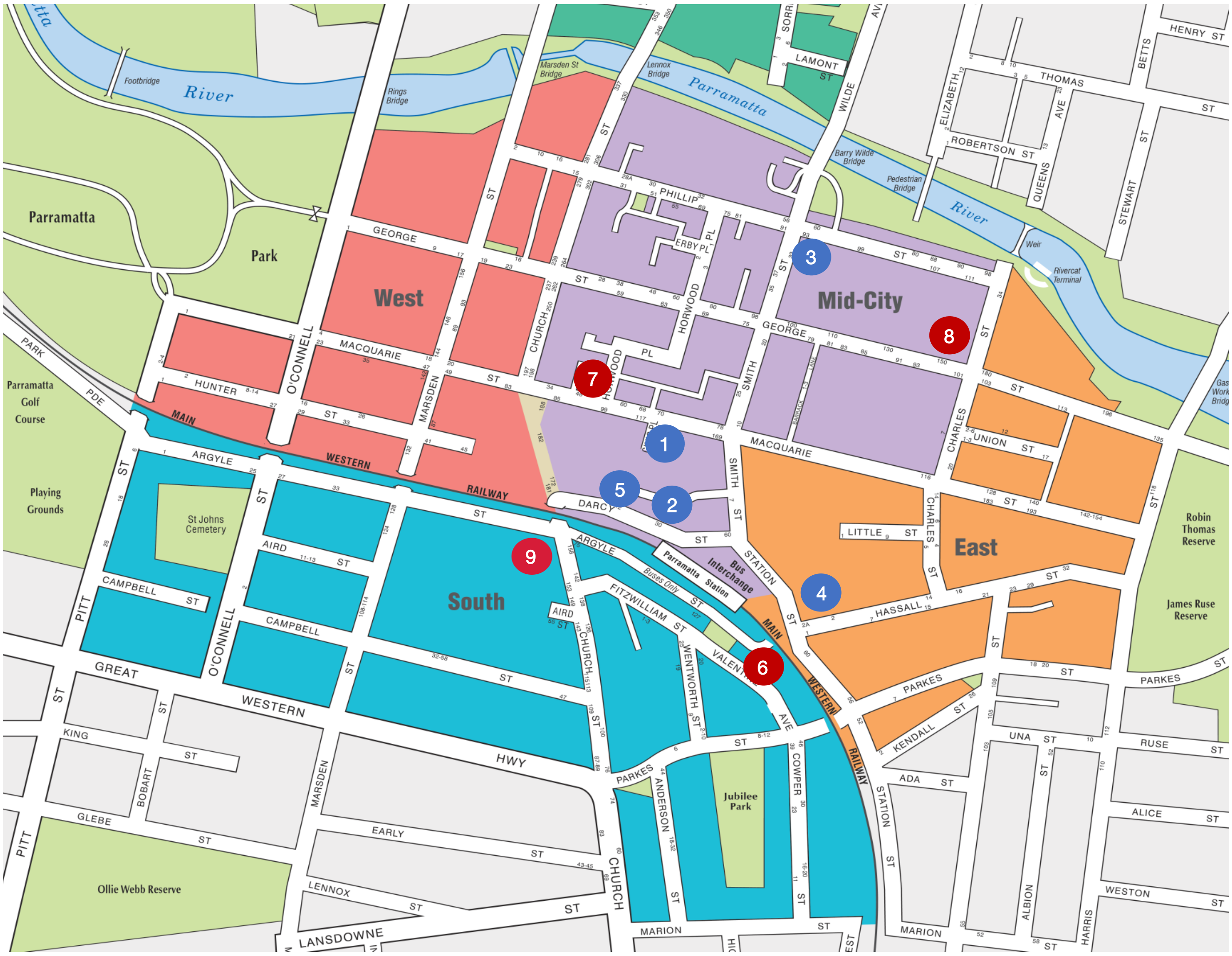
TABLE 3

Recent Sales Activity Parramatta ($10m+)

Address	Price ($ mil)	Reported Mkt Yield (%)	NLA (sq m)	$/sq m NLA	WALE (yrs)	Vendor	Purchaser	Sale Date
9 George Street	44.3	5.67*	5,531	8,136	3.0	Hadley Green	CBIC#	Dec-18
33 Argyle Street	40.8	5.56	5,279	7,729	3.5	NSW Aboriginal Land Council	TE2 Roxy Argyle Pty Ltd	Nov-18
91 Phillip Street	56.6	5.10	6,094	9,296	2.7	Capital Property Funds	BlackRock	Oct-18
60 Station Street	277.6	5.34	25,729	10,789	4.0	REST	GPT	Aug-18

Source: Knight Frank Research   *passing yield   #City of Brisbane Investment Corporation

MAJOR OFFICE SUPPLY



Source of map: Knight Frank

1. Parramatta Square Stage 3^ - 43,000m² [NAB]
   Walker Corporation - H2 2020
2. Parramatta Sq. Stage 4^ - 65,000m² [NSW Government]
   Walker Corporation - H2 2019
3. 32 Smith St - 26,000m² - [QBE -51%]
   GPT - H2 2020
4. 2-6 Hassall Street - 27,000m² [UNSW & WSU]
   Charter Hall -Q3 2021
5. Parramatta Sq. Stage 6&8^ - 120,000m² [NSW Governement]
   Walker Corporation - 2022
6. 2-10 Valentine Street - 28,000m²
   Australian Unit - 2022+
7. Greenway Plaza - 35,000m²
   Coombes Drivas - 2022+
8. 140 George Street - 45,000m²
   Dexus -2022+
9. Westfield, 159 Church St - 112,000m²
   Scentre Group - 2022+

- Under Construction/Complete (blue)
- DA Approved / Confirmed / Site Works (black)
- Mooted / Early Feasibility (red)

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

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