PARRAMATTA

OFFICE MARKET BRIEF APRIL 2016

Key Facts

Total vacancy measures 5.6%, while prime vacancy remains much tighter at 1.7%, clearly the lowest prime vacancy rate across all Sydney office markets.

The construction of Parramatta Square is well underway, however pre-commitments are still yet to be finalised for Stages 3, 5 and 6.

Since April 2015, prime annual face rental growth has measured 3.1%, while growth was stronger in secondary at 4.5%.

Prime yields have firmed 100 bps over the past year to April, while secondary yields have firmed 119 bps.

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With most large prime investments trading in 2013 and 2014, investment activity has been lower, albeit demand from investors remains strong. The prime market vacancy rate has compressed further to 1.7% - tenants looking to upgrade or expand are predominantly being driven towards refurbished secondary assets.

Development Activity

There have been no new developments reach completion in Parramatta since Eclipse in 2012. Instead, activity has been limited to refurbishments. In 2015 this included the refurbished backfill space at 1-3 Fitzwilliam Street (9,785m²), where Raffles Education occupies two thirds of the building (as owner occupier). However, the first stage of Parramatta Square has almost reached completion (expected early 2017), with Western Sydney University (WSU) occupying the entire site.

With the Parramatta market having entered the early phase of a commercial development upswing, the current hiatus in new supply will be short lived. The regeneration of new supply is largely underpinned by Parramatta Square, where the first stage of the development, known as 1PSQ (169 Macquarie Street), is under construction having achieved a 26,000m² pre-commitment from WSU. 1PSQ is owned by two of Charter Hall's managed funds and is being developed by Leighton Properties and constructed by John Holland.

Walker Corporation has been appointed by Parramatta City Council as the developer for the two largest development sites of the Parramatta Square development. One of these stages is known as Stage 2 and comprises the Aspire residential tower. The other is known collectively as Stages 5 and 6, which comprise the largest commercial component of the redevelopment precinct and will provide up to 126,000m² of commercial space across two towers in addition to a podium retail component. Parramatta City Council is to appoint a developer for the 32,000m² Stage 3 office building imminently (see development map). Additionally, 105 Phillip St, fully owned by DEXUS, is expected to reach completion in 2018+, with the NSW Department of Education recently fully committing to the 25,000m² office building.

Residential activity in Parramatta is currently strong. Approximately 7,000 apartments are due to complete within the next five years, with many proposed residential towers stemming from office tower demolitions. Change of stock withdrawals have totalled 8,434m² (1.2% of current office stock) over the past two years. In order to supplement the strong population growth in Western Sydney, office withdrawals are expected to pick-up further over the next few years, with 14-20 Parkes St on the market for sale, which is an office site proposed for residential, mixed-use conversion.

Net Absorption & Vacancy

Vacancy rates as at January 2016 decreased by 180 bps to measure 5.6% (vs 7.4% as at July 2015). Split by grade, vacancy rates have decreased by 70 bps to 1.7% for prime and 230 bps to 8.3% for secondary since July 2015. The very tight prime vacancy rates remain trending below the 10 year average of 3.1%. Parramatta's prime vacancy rate is also the lowest of suburban markets in Sydney—with Crows Nest/St Leonards and Macquarie Park behind at 3.5% and 4.8% respectively.

Historically, net absorption in Parramatta has been driven by the supply cycle and to this effect, the absence of recent supply completions, the particularly low vacancy rate and the lack of prime leasing options have partly contributed to a lack growth in occupied space. Although few in number, there have been large space enquiries across the Parramatta market—including a circa 8,000m² enquiry by Origin Energy for both the Sydney CBD and broader suburban market. However, leasing activity in the prime market is restricted by a lack of vacant space with stock levels for large prime spaces (750m²+) being very limited—except for pre-commitments available in the Parramatta Square development. HSBC at 10 Smith St are renewing their lease at their current premises, due to the severe undersupply of prime spaces available in the market.

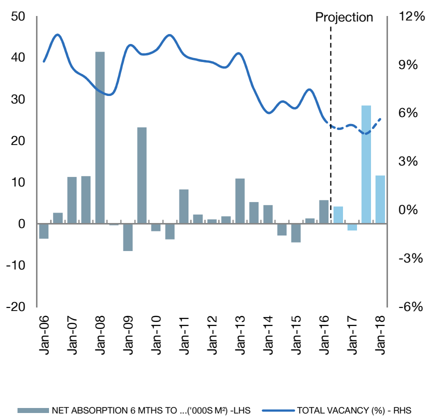
Changes in occupied stock levels have been relatively minor over the past 18 months—due to the lack of quality leasing options coupled with the shortage of large spaces available. While some tenant displacements stemming from change of use withdrawals resulted in modest negative net absorption in 2014, the result is now positive in 2015. Vacancy rates are expected to remain relatively tight over the next two years, notwithstanding 1PSQ and 105 Phillip St in the development pipeline, expected to reach completion in early 2017 and 2018+ respectively. WSU have pre-committed to the entire 1PSQ development as sole tenant, while the NSW Department of Education has recently announced it will be pre-committing to the entire 105 Phillip St development—with 1,800 staff relocating from Sydney CBD.

Rents & Incentives

Rentals in both the prime and secondary market continue to grow, in part due to the relative tightness of the market. Average prime net face rents currently measure $434/m² ($545/m² gross), reflecting annual growth of 3.1%. Prime net incentives have held broadly steady and range between 20% and 25%. This level of incentive is higher than would normally be expected for a market with a sub 3% vacancy rate—arising in response to competition from other suburban markets.

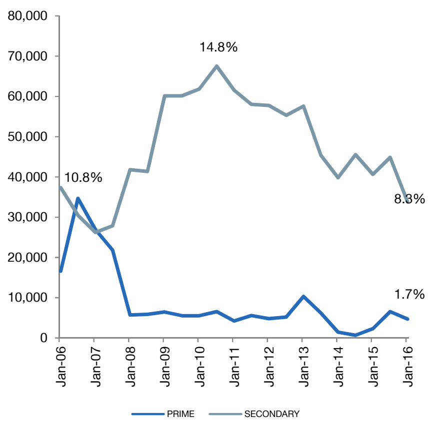
The recent momentum in rental growth is forecast to be sustained throughout 2016 and 2017, in response to the prime

FIGURE 1
Net Absorption and Vacancy
Per six month period (000's, %)



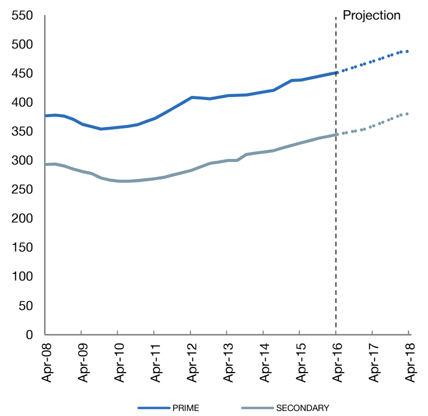
Source: Knight Frank Research/PCA

FIGURE 2
Parramatta Vacancy
Total vacancy by grade (m²)



Source: Knight Frank Research/PCA

FIGURE 3
Average Gross Effective Rent
Parramatta ($/m²)



Source: Knight Frank Research

TABLE 1
Parramatta Office Market Indicators as at April 2016

Grade	Total Stock (m²)^	Vacancy Rate (%)^	Annual Net Absorption (m²)^	Annual Net Additions (m²)^	Average Gross Face Rent ($/m²)	Outgoings ($/m²)	Average Incentive (%)	Average Core Market Yield (%)
Prime	273,617	1.7	-2,401	0	545	111	21.6 (net)	6.75 - 7.50
Secondary	409,290	8.3	9,399	2,590	460	110	25.0 (gross)	7.50 - 8.25
Total	**68,2907**	**5.6**	**6,998**	**2,590**				

Source: Knight Frank Research/PCA ^ Data as at January 2016 * Upper prime assets with long WALEs are trading below this range (sub 6.75%)

vacancy rate remaining relatively tight over the next two years. Prime face rental growth is expected to be slightly in excess of CPI during these two years, with average growth of 3% per annum forecast. A fall in incentives to 15%- 20% is expected by 2018, which will result in effective rental growth of approximately 5.0% per annum over the next two years. However, the degree of any reduction will partially be offset and directed by the competing, relatively high incentives in other Sydney suburban markets. Thus, pre-lease competition will remain strong as developers look to progress the market's supply pipeline.

The limited availability of prime grade office stock has driven tenants to secondary grade space to satisfy their tenancy needs. Demand has been most prevalent in lower A-grade and upper B-grade facilities which have undertaken refurbishment. As such, refurbished secondary assets justify strong rental growth, and these refurbished spaces are a key requirement for many large tenants. Secondary net face rents currently average \$350/m² (\$460/m² gross) - a strong annual increase of 4.5%. Secondary incentives continue to remain stable at 25% gross, however moderate downward pressure is expected over the next two years.

TABLE 2

Recent Leasing Activity Parramatta

Address	NLA (m²)	Face Rental (\$/m²)	Term yrs	Lease Type	Tenant	Date
105 Phillip St	25,000	Conf	Conf	Pre-com	Department of Education	Jan-18
One Parramatta Sq.	24,500	540n	15	Pre-com	WSU	Dec-16
L1-3, 10 Smith St	3,422	415n	10	Renewal	HSBC	Jul-16
10 Smith St	1,776	402n	7	Renewal	Matthew Folbigg	Feb-16
80 George St	477	430n	3	Renewal	Wipro	Jan-16
91 Phillip St	940	365n	5	Renewal	Cunningham Lindsey	Dec-15

Source: Knight Frank Research n refers net

Investment Activity & Yields

Recent sales activity in the Parramatta region has remained relatively stable over the past 12 months, with a total of seven properties transacting in the 2015 calendar year. No transactions have been recorded since October last year, however, there are three currently in progress and at their final stages of completion, while a large prime asset has reportedly just been put on the market for sale.

Investment sales over the past 12 months (to April) amount to \$205.9 million across nine commercial properties (\$5 million+). The bulk of major prime Parramatta assets have been sold over 2013 and 2014, including the Justice Precinct, Sydney Water, Eclipse and NSW Police. However, investor demand still remains high in Parramatta, with large interest arising when a new asset comes to market. Across the 12 months to April, buying activity has been solely concentrated on sub \$50 million secondary assets in the market—purchased primarily by local buyers—unlisted funds, syndicates and private investors.

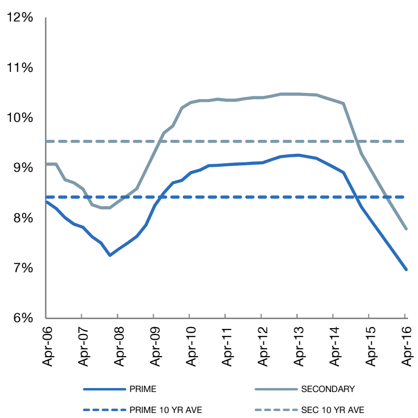
Yields continue to compress across Parramatta, with the market now witnessing yields firmer than the nadir experienced in January 2008 at the onset of the global financial crisis (Figure 4). Average prime and secondary yields across the broader Parramatta market have compressed 100 bps and 119 bps respectively since April 2015, to now range between 6.75% to 7.50% and 7.50% to 8.25% (assuming a five year WALE). Substantial downward pressure has tightened yields every quarter since their peak in April 2013.

The Parramatta prime and secondary markets are now trading at yields 144 bps and 174 bps below the 10 year average

FIGURE 4

Average Core Market Yields

Parramatta (%)



Source: Knight Frank Research

TABLE 3

Recent Sales Activity Parramatta

Address	Price (\$ mil)	Core Mkt Yield (%)	NLA (m²)	\$/m² NLA	WALE (yrs)	Vendor	Purchaser	Sale Date
93 George St	37.2	8.50	7,127	5,234	2.9	Marprop	Rathdrum	Oct-15
17-21 Macquarie St	18.8	8.10	4,718	3,975	2.1	Caleven Property	Lederer Group	Sep-15
20 Charles St	31.1	7.90	6,364	4,871	2.9	Global Three	Rathdrum	Jul-15
9 George St	30.0	7.50	5,414	5,541	2.4	Hyperion Property Syn.	Hadley Green Investment Group	Jun-15
91 Philip St	30.0	8.00	5,704	5,259	3.3	Fortius	Capital Property Funds	Jun-15
80 George St	38.7	8.00	8,184	4,729	3.1	Heathley Asset Mgmt	GDI Property Group	Apr-15

Source: Knight Frank Research

respectively, as at April 2016. The firming of yields in the Parramatta market is in part reflective of a re-rating of the market positioning itself as Sydney's second CBD, but also in part due to an uncertain share market over the past 12 months.

The most recent transaction in Parramatta was the October sale of 93 George St, purchased for $37.2 million by Rathdrum Properties. Secondary stock is likely to continue to trade over the short term, with investor demand remaining high and some vendors likely to crystallise profits following the firming in yield metrics.

Outlook

The Parramatta market is expected to undergo significant supply rejuvenation over the next five years, as substantial developments come to fruition including individual stages of Parramatta Square and 105 Phillip St. Forthcoming supply coupled with the departure of Commonwealth Bank of Australia (101 and 150 George St) to the Australian Technology Park (2020+) will result in some much needed supply to the Parramatta market, however the 39,891m² of backfill space (5.8% of total office stock) which they currently occupy will need to be digested in the medium term.

Off the back of the increased supply pipeline, it is expected that some major existing tenants will relocate into the new prime space while backfill space is predicted to be absorbed by tenants displaced by residential conversions from both Parramatta and other suburban markets. Vacant space is expected to remain tight which is anticipated to result in strong effective rental growth over the next two years, supported by a fall in average incentive metrics.

Given the strong appetite for commercial property—providing higher comparable yields against historically low government bond rates—strong investor demand is expected to continue. This demand will include any core opportunities as well as value add and core plus assets. While Parramatta's prime assets have been tightly held in recent years, a number of 'trophy' assets are expected to be brought to the market during 2016.

As Parramatta Square continues to develop, we are likely to see pre-commitments emerge from both existing Parramatta tenants, suburban tenants, displaced government agencies and some corporate operations decentralising from Sydney CBD.

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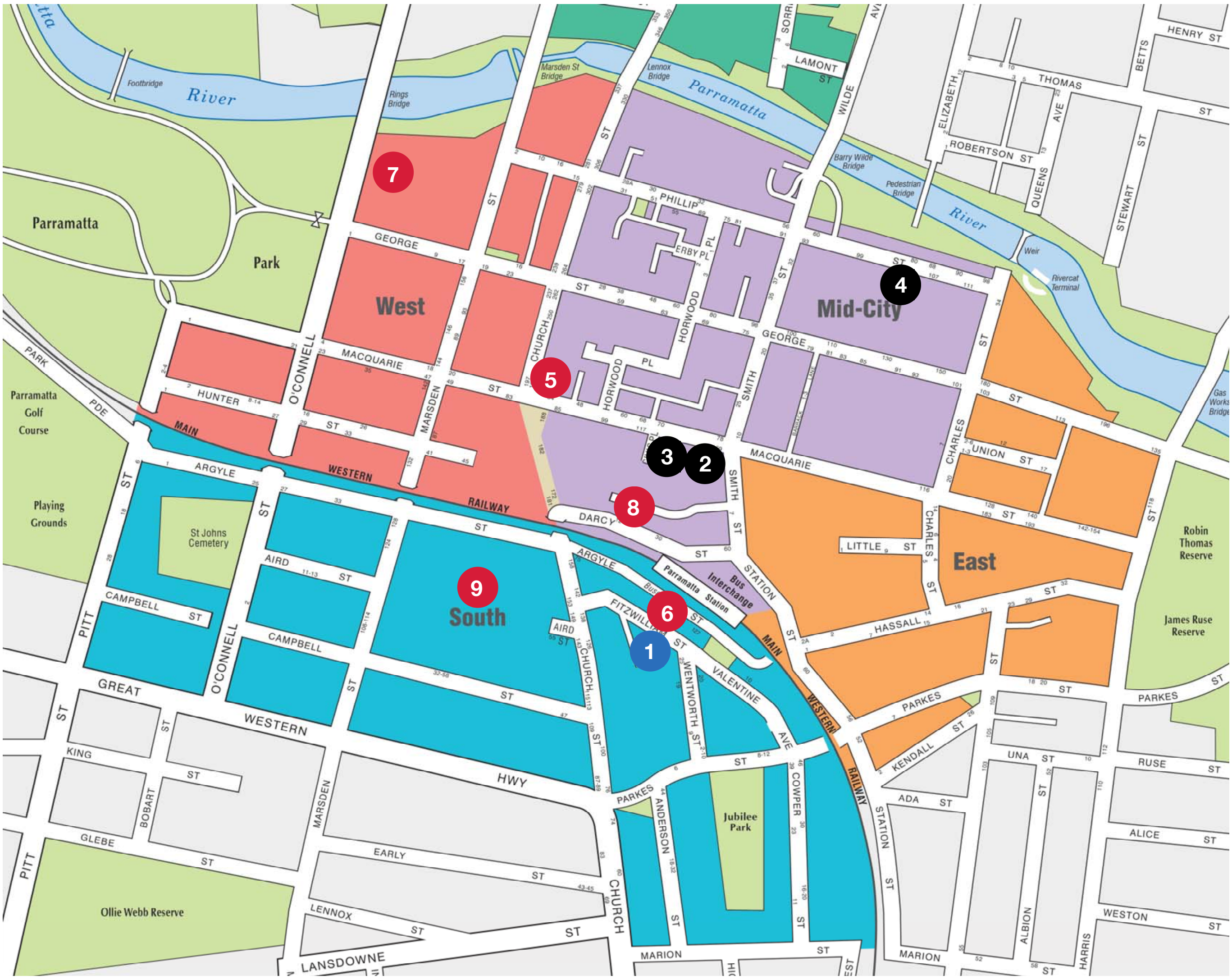
MAJOR OFFICE SUPPLY



Source of map: Knight Frank

1. 1-3 Fitzwilliam St# - 9,785m² [Raffles as owner occupier] ICUC Holdings - Q2 2015 - 85% committed
2. 1PSQ, 169 Macquarie St^ - 26,000m² [WSU] Leightons/Charter Hall - early 2017 - 100% committed
3. 153 Macquarie St (Stage 3)^ - 32,000m² *Parramatta City Council - 2018+
4. 105 Phillip St - 25,000m² [NSW Department of Education] DEXUS - 2018+ - 100% committed
5. Greenway Arc, 48 Macquarie St - 27,500m² Drivas/Telado - 2018+
6. 2 Fitzwilliam St - 16,260m² Transport for NSW - 2018+
7. 2 O'Connell St - 32,000m² Government - 2019+
8. Parramatta Sq. Stages 5 & 6^ - 126,000m² Parramatta City Council (Walker) - 2019+
9. Westfield, 159 Church St - 34,000m² Westfield - 2020+

- 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
Major refurbishment
^ Part of Parramatta Square project
* Preferred developer to be announced imminently