

PARRAMATTA

OFFICE MARKET BRIEF SEPTEMBER 2017



Key Facts

As at July 2017, Parramatta's overall vacancy rate measured 4.3%, remaining at a historical low.

105 Phillip Street (25,000m²) is under construction and is due for completion in Q1 2018 to be occupied by the NSW Department of Education.

Rental growth has been significant with prime and secondary effective rents increasing **by 8.7% and 13.1% respectively** over the past year.

Total transaction volumes in the 12 months to July 2017 totals \$397 million, more than double the previous corresponding period.



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Significant Government and Corporate pre-commitments continue to drive the office development pipeline in Parramatta, highlighting the strong confidence in the market, and resulting in the record low vacancy levels of 4.3%.

Development Activity

Parramatta is in the midst of its development boom with a number of key office developments well underway, in conjunction with earmarked infrastructure projects, which are on track to revitalise the Parramatta CBD. Although no new supply was added in the six months to July 2017, following the completion of 1PSQ (26,000m²) for WSU in late 2016, the next wave of supply will stem from Dexus' 105 Phillip Street (25,000m²) which is under construction and due for completion in Q1 2018. Additionally, works have begun at 3PSQ (43,000m²) which will house NAB from 2020 along with 4PSQ (65,000m²) fully-committed to the NSW Government from completion in mid-2019.

Office stock withdrawals continue to pave the way for alternative developments across Parramatta. In the six months to July 2017, 767m² was permanently withdrawn, stemming from 20 Hunter Street for future redevelopment. The purchase of 32 Smith Street (Salvation Army Site) by GPT for \$31.2 million will see approximately 566m² withdrawn from the market at the end of 2017 to make way for a new \$230m office tower.

The proposed commercial development will provide approximately 28,000m² with delivery expected in early 2020. Looking further ahead, in addition to future sites in PSQ, potential new supply is earmarked for development from Westfield at 159 Church Street (potential 100,000m²), Greenway Plaza (30,000m²) and Dexus' 140 George Street (40,000m²).

Infrastructure development and Government investment into Western Sydney are driving demand for commercial space in the Parramatta CBD. The recent announcement from NSW Premier Gladys Berejiklian that the Powerhouse Museum will move to the old David Jones carpark site on the banks of Parramatta River is a significant step towards boosting Parramatta as a destination hub for not only residents and workers but as a visitor and tourist destination. Furthermore, the Parramatta light rail project, which is due to begin construction in 2018, will enhance connectivity between Parramatta and its surrounding suburbs, in conjunction with the proposed \$15 billion Sydney Metro West project, linking Parramatta to the CBD.

Net Absorption & Vacancy

The overall vacancy rate as at July 2017 remained unchanged at the historical low of 4.3%, well below the 10 year average of 7.7%. No new supply to the market and no available stock in the prime market have been the catalyst behind the historical low vacancy rate.

Split by grade, the prime market recorded no available space, a figure which has remained static since January 2016, making Parramatta the tightest prime office market in the country. With no speculative office developments in the pipeline and the addition of 105 Phillip Street and 3PSQ already pre-committed to the Department of Education and NAB respectively, the prime vacancy rate is expected to remain at or close to zero for at least the coming 18 months.

The secondary market continued to tighten with the vacancy rate dropping slightly to 7.4% from 7.5% as at July 2017. With zero vacancy in the prime market, tenants are being forced to

seek alternative space in the secondary market or renew at their current locations.

Notable deals in the secondary market include iCare (GPNSW) leasing 2,954m² at 56 Station Street, HCF leasing 1,888m² at 75 George Street and the RMS renewing leases over 10,294m² at 27 Argyle Street.

Following H2 2016 which saw net absorption levels (24,546m²) at its highest level since 2007, the six months to July 2017 recorded negative take-up of 212m², stemming from the withdrawal of 20 Hunter Street. With the completion of 105 Phillip Street due in Q1 2018 and 25,000m² pre-committed to the Department of Education moving from the Sydney CBD, absorption levels are anticipated to mirror the levels recorded in January 2017 when the completion of a 100% leased 1PSQ boosted tenant absorption figures.

Historically, net absorption in Parramatta has been driven by the supply cycle, and to this effect, the absence of new supply and a moderate withdrawal of stock in the first half of 2017 (20 Hunter Street) contributed to the fall in occupied space.

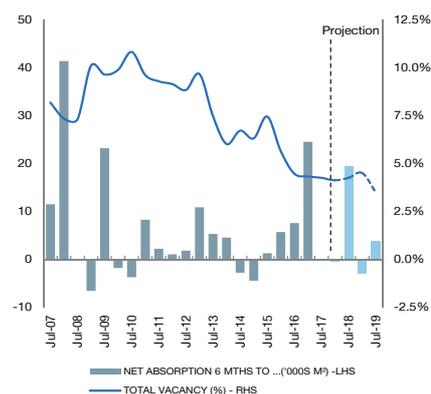
Rents & Incentives

Parramatta's tightening vacancy rate continues to drive face rental growth in both the prime and secondary markets, amidst no new available stock coming to market in 2017.

The average prime gross face rent recorded its largest annual increase in five years of 6.8% to average \$606/m² (\$494/m² net). Prime net incentives have remained steady in the six months to July 2017 at 18.4% and this is anticipated to tighten in the near term as owners capitalise on the favourable market conditions. The steady incentive rates resulted in gross effective rents rising 8.8% to \$514/m² in the past 12 months. Prime face rents are forecast to grow at an average of 4.25% p.a over the next two years until new stock comes to market including the departure of CBA at 150 and 101 George Street which will ease pressure on rents.

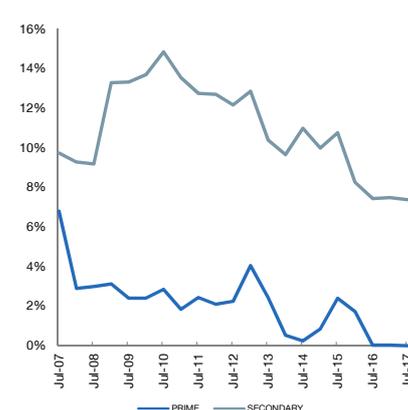
With no available stock in the prime market, tenants are forced to either seek space in surrounding suburbs, such as Rhodes and Sydney Olympic Park, or look at alternative secondary stock in Parramatta.

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



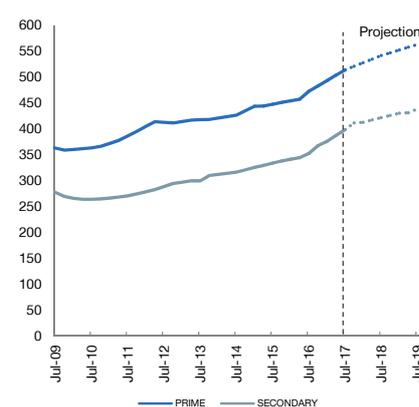
Source: Knight Frank Research/PCA

FIGURE 2
Parramatta Vacancy
Total vacancy by grade (%)



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 July 2017

Grade	Total Stock (m ²)	Vacancy Rate (%)	Annual Net Absorption (m ²)	Annual Net Additions (m ²)	Average Gross Face Rent (\$/m ²)	Outgoings (\$/m ²)	Average Net Incentive (%)	Average Core Market Yield (%) [^]
Prime	299,617	0.0	26,070	26,000	606	112	18.4	5.95 - 7.00*
Secondary	406,715	7.4	-1,736	-2,137	505	115	21.0	6.50 - 7.50
Total	706,332	4.3	24,334	23,863				

Source: Knight Frank Research/PCA

* Upper prime assets with long WALEs are trading below this range (sub 5.75%) ^ Based on an assumed 5 year WALE

In the secondary market gross face rents have seen even stronger growth than prime rents with an annual increase of 7.4% to \$505/m² (\$390/m² net). On the back of average secondary incentives falling to 21.0%, gross effective rents have increased by 13.1% in 12 months to \$399/m² (\$284/m² net).

Investment Activity & Yields

The Parramatta office market has experienced strong investment activity over the 12 months to July 2017 with five transactions (\$10m+) totaling \$397 million recorded, more than double the 2015/16. The increase in sales volumes has been aided by the recent major sale of 105 Phillip Street, purchased by the Charter Hall Prime Office Fund for \$229 million from Dexus. The asset, leased to the Department of Education on a 12 year WALE over 25,000m² from completion, sold on a reported core market yield of 5.31%. This becomes the Parramatta CBD's tightest yield surpassing the sale of the Parramatta Justice Precinct (6.27%).

Investor demand has been dominated by domestic unlisted funds and syndicates over the past 12 months accounting for 87% of the total transactions. In addition to the sale of 105 Phillip Street, the other notable sales include 18 Smith Street to Eureka Funds Management for \$84.03 million and the purchase of 32 Smith Street (Salvation Army Site) for redevelopment by GPT for \$31.20 million, which has the potential for 28,040m² of office GFA. GPT is yet to announce any pre-commitments for the site, thus providing an opportunity for a new tenant to enter the market or allow for expansionary space for existing Parramatta tenants.

TABLE 2

Recent Leasing Activity Parramatta

Address	NLA (m ²)	Face Rental (\$/m ²)	Term yrs	Lease Type	Tenant	Date
126 Church Street	510	490g	3+3	New	AECOM	Jul-17
27 Argyle Street	10,294	262n	3+3	Renewal	RTA	Jul-17
56 Station Street	2,954	380n	5+5	New	GPNSW (iCare)	Jul-17
80 George Street	270	522n	6+6	New	Tax Factor	Jul-17
88 Phillip Street	1,115	420n	7	New	Burbank	Jun-17
75 George Street	1,888	450n	6+5	New	HCF	May-17

Source: Knight Frank Research n refers net g refers gross

Offshore investment remains steady with the only offshore purchase being the sale of 80 George Street in Q3 2016 to a private offshore investor. The asset was sold on a core market yield of 6.76% reflecting the strong demand for offshore investors wanting to enter the tightly held Parramatta office market.

Underpinned by investment demand and fuelled by an increase in face rents and incentives remaining steady over the past six months, yields have continued to compress in both the primary and secondary markets. Average prime yields have compressed by 20bps to 6.22% in the six months to July 2017 and tightened 144bps since July 2015. The strength of the prime market is evidenced by the sale of 105 Phillip Street which traded on a reported core market yield of 5.31%. The asset purchased by Charter Hall POF has set the benchmark for core assets in Parramatta.

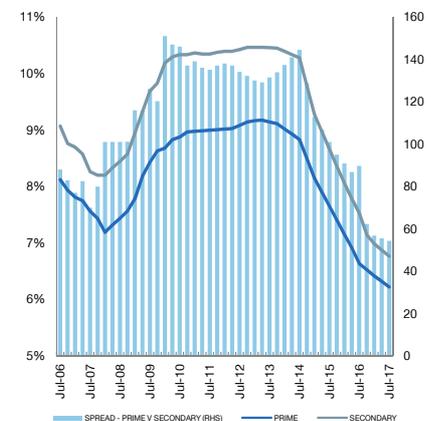
In the secondary market yields have continued to compress amidst an increase in the number of both offshore and domestic investors looking for an entry into the Parramatta market.

Secondary yields have compressed 76bps over the 12 months to July 2017. Driven by significant net effective rental growth in the past year of 19.44% and a tightly held prime market the secondary market continues to close the gap to the prime market with the spread at an all time low of 54bps.

FIGURE 4

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 (m ²)	\$/m ² NLA	WALE (yrs)	Vendor	Purchaser	Sale Date
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
32 Smith Street ~	31.2	N/A	566*	-	-	Salvation Army	GPT	Jan-17
41-59 George Street ~	23.0	N/A	2,230	-	-	Private	Holdmark	Dec-16
80 George Street	51.8	6.76	8,196	6,330	3.3	GDI Property Group	Private Offshore Investor	Oct-16

Source: Knight Frank Research

~ Site was bought for redevelopment

* Excludes The Salvation Army NLA

>Reported



Outlook

The prime vacancy rate is expected to remain at or near zero for the next 18 months as the next wave of new supply at 105 Phillip Street and 3PSQ has been fully pre-committed by tenants moving into the Parramatta market. This will put further pressure on the secondary stock market and it is likely that the market will see a decline in the total vacancy rate.

Prime effective rental growth is anticipated to remain strong at approximately 4.5% p.a over the next two years as available stock remains tight. Rental growth will ease to approximately 3.5% thereafter as more available stock comes online largely stemming from CBA vacating at 101 and 150 George Street.

Net absorption in Parramatta over the next four years is forecast to be around 36,000m² per annum, more than triple the 10 year average of 12,000m² per annum mainly due to the number of large pre-commitments (NAB and GPNSW at PSQ and NSW Education at 105 Phillip Street.

With the boost in office supply over the next four years predominantly pre-committed A Grade stock, prime vacancy is anticipated to remain below 1% and overall vacancy to trend below 4% in the coming years.

Investment activity in Parramatta is expected to remain strong and one of the most tightly held office markets in the country. The yield spread between primary and secondary stock is likely to narrow as investors look to pay a premium to enter the Parramatta market.

Office stock in Parramatta is anticipated to reach approximately 1,000,000m² by 2022 assuming all potential developments in the pipeline go ahead. This would make Parramatta the largest office market in NSW outside of the Sydney CBD, overtaking North Sydney and Macquarie Park.

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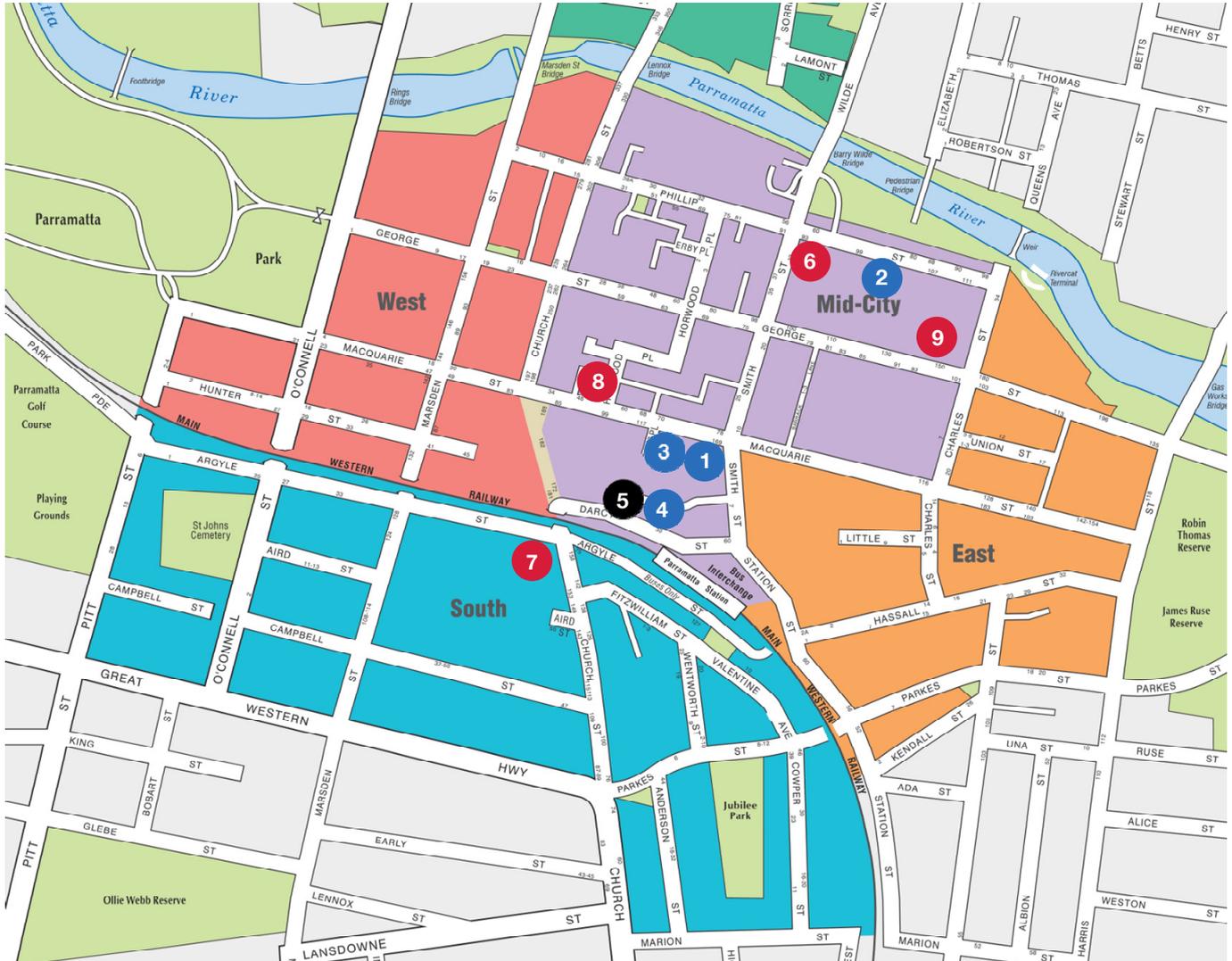
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Global

MAJOR OFFICE SUPPLY



Source of map: Knight Frank

- 1 1PSQ, 169 Macquarie St[^] - 26,000m² [WSU, PwC, Water NSW]
Charter Hall - 2016 - Complete
- 2 105 Phillip St - 25,000m² [NSW Department of Education]
Charter Hall - March 2018 - 100% committed
- 3 153 Macquarie St (Parramatta Square Stage 3)[^] - 43,000m² [NAB]
Walker Corporation - Mid 2020
- 4 Parramatta Sq. Stage 4[^] - 65,000m² [NSW Government]
Walker Corporation - Mid 2019
- 5 Parramatta Sq. Stage 6[^] - 45,000m²+
Walker Corporation - 2021+
- 6 32 Smith St - 28,048m²
GPT - 2019+
- 7 Westfield, 159 Church St - 35,000m² #
Scentre Group - 2020+
- 8 Greenway Plaza - 30,000m²
Coombes Drivas - 2021+
- 9 140 George Street - 40,000m²
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 100,000m²