VALUATION AND ADVISORY

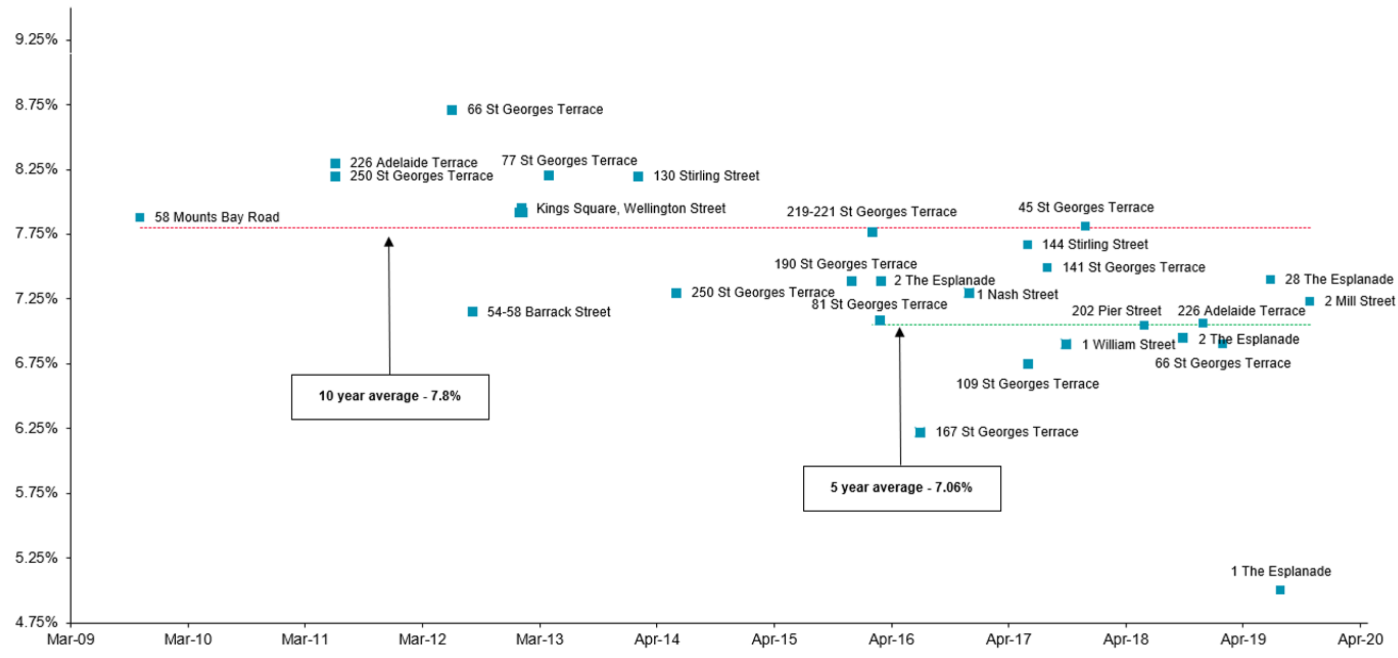
CUSHMAN & WAKEFIELD

PERTH CBD OFFICE MARKET OVERVIEW - PAST, PRESENT & FUTURE

TRANSACTIONAL ACTIVITY AND YIELDS.

The Perth Central Business District (CBD) office market has experienced mixed profiles over the past decade. Over this period the market has weathered the tail end of a global financial crisis, a mining downturn, a pandemic and now a recession.

The chart below outlines office transactions in excess of $50million occurring within the Perth CBD over the last 10 years.



Note: This chart does not include every sale only representative trend sales

Perth CBD Office Yields - Cushman & Wakefield Valuations

Key points:

- Low transaction volumes post-GFC across 2009 and 2010, including three lower capital value receivership sales;
- An uplift in transactions to pre-GFC levels with 8 to 11 recorded per annum throughout 2011 to 2013, including significant 50% shares in QV1 (250 St Georges Terrace), Exchange Plaza (2 The Esplanade), and 108 St Georges Terrace;
- A decline in volume with only five sales recorded throughout 2014 and 2015, coinciding with the deterioration of the leasing market. Signs of yield compression begin to emerge across the spread of Prime and Secondary transactions;
- A moderate increase in activity from 2016 onwards, driven in part by the sale of the Insurance Commission of Western Australia's divestment of The Forrest Centre (219-221 St Georges Terrace), Westralia Plaza (167 St Georges Terrace), and Westralia Square (141 St Georges Terrace);
- In the year from mid-2017 to mid-2018, eight settled sales occurred, indicating a further tightening in yields across the market, with offshore purchasers being particularly active in accounting for around 75% of transactions; and
- Strong demand, but limited supply through 2018 with a handful of sales of mainly A and B grade buildings, and one premium building being Exchange Tower (2 The Esplanade).
- Strong demand for larger office buildings continued through 2019 with a wide variety of Prime, A, B & C-Grade assets achieving yields from 5.0% to 7.5%, noting the 5.0% yield reflected the acquisition of the proposed Chevron Tower (1 The Esplanade) situatedon a prime lot within Elizabeth Quay.

- Market activity ground to a halt in early 2020 as a result of the COVID-19 pandemic, resultingly no major transactions ($50million +) have occurred through the first part of 2020, although at the very beginning of the year there remained a situation of little supply but strong demand. Whilst the impact of the current Coronavirus pandemic is being felt through recent volatility in the share market and reported tightening in credit markets which are now cautioning investors and impacting upon confidence. Anecdotal evidence from a number of recent sales campaigns suggests purchasers are "less motivated" and that a "wait and see" approach is prevailing in the market. These uncertainties create greater pricing/value risk, the precise impact of current market issues cannot be confirmed/measured until such time that a weight of sales occurs under the prevailing conditions. The situation should be closely monitored.
- Notwithstanding the above, we have witnessed a variety of smaller assets (office & retail shopping centres) in the quantum range of $10-35million transacting during the COVID-19 pandemic at yields comparable to pre-pandemic levels. As there is currently limited supply of stock available displaying secure lease covenants and lengthy weighted average lease expiry (WALE) terms, demand for this stock (when it eventuates) is high, resulting in strong yields being achieved towards the lower end of market norms, particularly where the WALE by income is in excess of 5 years.
- The chart visualises a notable compression in market yields having occurred over the past decade and more specifically over the last 5 years.
- The compression in yields has been primarily driven by falling cash rates and the abundance of funds available in the market seeking a secure investment vehicle. Additionally, the demand for Western Australian assets has been underpinned by higher levels of return achievable in the state when compared to the eastern states.
- Although owners/funds are capable of capitalising on these low yields there is a general consensus in the market, that as a result of the limited supply of stock, a vendor would have limited options as to where they could re-invest their funds should a sale be achieved; as such they are often hesitant to dispose of an asset which guarantees a secure return. On this basis we consider the sales which have occurred during the pandemic to have been highly opportunistic.

Looking forward, the Reserve Bank of Australia has indicated it is unlikely to raise the cash rate until *"progress is being made towards full employment and it is confident that inflation will be sustainable within the 2-3% target band"* and in current forecasts this isn't expected to occur until 2022/23.

On the basis of bond yields and interest rates being at record lows, investment demand should be strongly underpinned by the margins between cost of borrowing and commercial returns being at record highs. The issue however arises as some property income fundamentals are in unchartered waters, having not been experienced in previous recessions or market downturns. At the forefront, albeit not limited to, is determining how working from home (WFH) models, social distancing requirements and co-working will impact businesses office space requirements. Given the uncertainty of these factors, future vacancy and net absorption trends are difficult to forecast at this point in time.

As a result of these uncertainties it is expected that investors in the WA market will shift away from "value add" propositions witnessed throughout 2018/19, to assets underpinned by strong lease covenants and lengthy WALE terms which will provide a secure return during these uncertain times.

Should you have any queries with relation to this overview, please do not hesitate to contact the Perth team below.

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