PCA Office Market Report Overview
August 2014

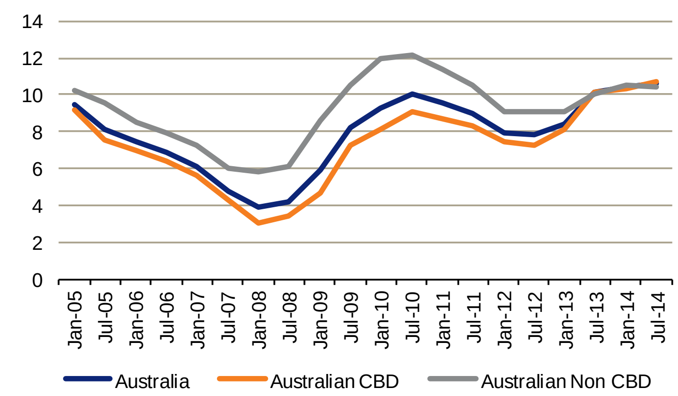
- **Absorption data highlights that the recovery of Sydney and Melbourne CBD markets is now entrenched.**
- **However other CBD markets remain weak, particularly Brisbane and Perth.**
- **Tight conditions in the majority of fringe markets are driving increased re-centralisation.**
- **We expect demand momentum to improve and continued downward pressure on vacancy rates – particularly across the Eastern Seaboard.**

We are pleased to bring you an overview of the current state of the major Australian office markets. This report relies on historical property data sourced from the Property Council of Australia (unless otherwise stated) current as at August 2014. All analysis and views of future market conditions are solely those of Investa.

Demand momentum builds in Sydney and Melbourne while resource markets remain weak

The evidence of the Australian economy re-weighting away from mining investment can increasingly be observed in office market data. The overall Australian vacancy rate increased to 10.6%, the highest since the late 90s, but this statistic on its own does not tell the whole story. The Australian office market landscape at present is bifurcated as mining investment winds down and the economy re-weights to more traditional growth drivers, which is driving divergent conditions in different states and markets.

CHART 1: NATIONAL VACANCY RATES (%)

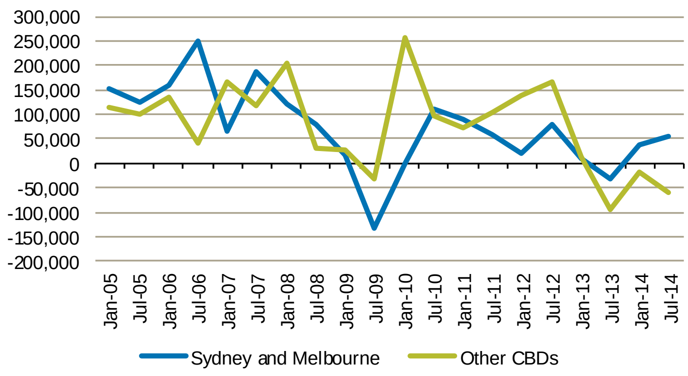


Source: PCA and Investa Research

On one hand, demand in both Brisbane and Perth have suffered due to mining-related tenants scaling back – with the added drag of State Government contraction continuing over the past 6 months.

At the same time improvements in both the international and domestic economy are being felt in Sydney and Melbourne. Tenant demand was positive (see Chart 2) in both markets; in line with the long-term average in Sydney and just below that in Melbourne, as professional services tenants in particular saw strong improvements in business conditions over the period.

CHART 2: ABSORPTION (SQM)



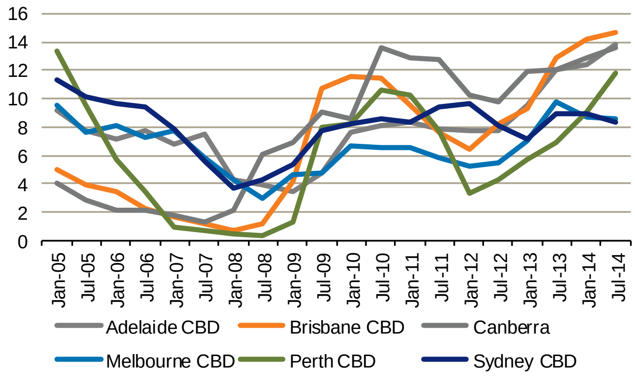
Source: PCA and Investa Research

The other CBD markets sit in between these two extremes, with Canberra and Adelaide both posting negative demand over the period. Canberra office demand is more aligned with the political rather than economic cycle, while Adelaide lags markets such as Sydney and Melbourne; and we expect that demand conditions will improve from here, in line with broader economic conditions.

Recovering demand drives vacancy rate improvements in Sydney and Melbourne

Net supply remains constrained in Sydney due to the increased impact of building withdrawals, combined with a benign gross supply pipeline until the delivery of the Barangaroo towers. Likewise, in Melbourne, much of the supply that was under construction has now been delivered. As a result the pick-up in absorption has led to an improvement in market vacancy with Sydney now sitting at 8.4% just above to long-term average. The Melbourne vacancy rate has also improved to 8.5% - down from nearly 10% 12 months ago (see Chart 3).

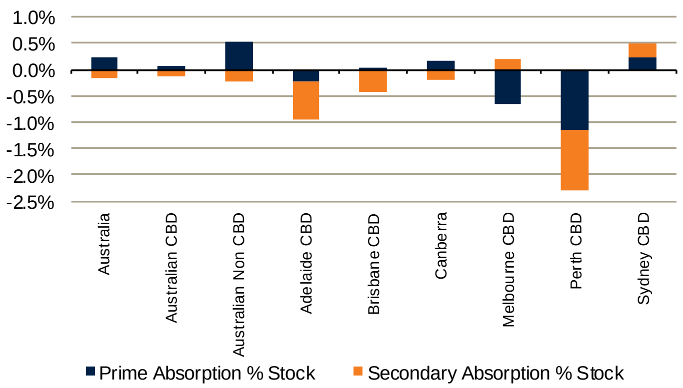
CHART 3: VACANCY RATES (%)



Source: PCA and Investa Research

Other CBD markets are still facing upward pressure on vacancy rates due to weak tenant demand. Perth in particular has seen vacancy increase sharply to nearly 12% - almost doubling in 18 months. Leading indicators suggest that we are through the worst, and we expect demand to improve to around neutral levels in both Perth and Brisbane by the end of CY14.

CHART 4: 6 MONTH ABSORBTION (% STOCK)

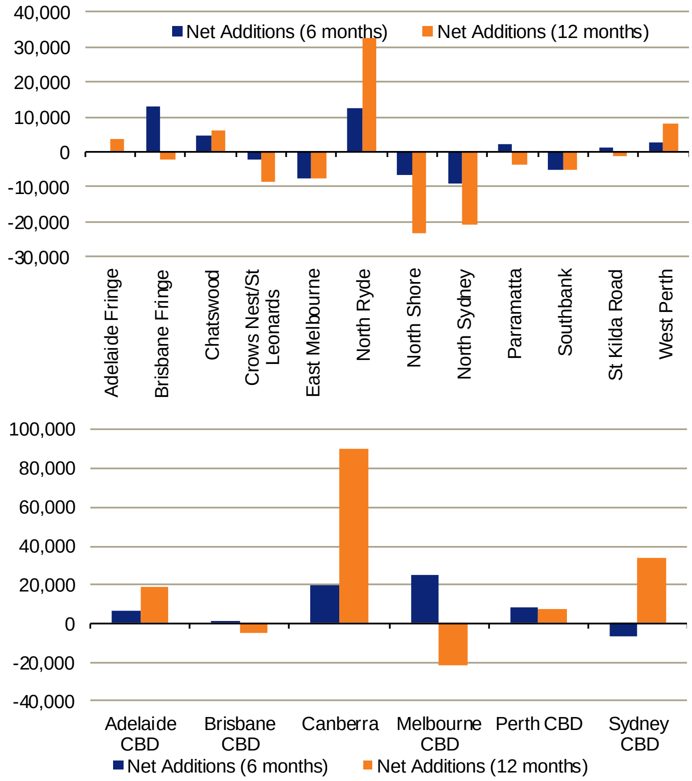


Source: PCA and Investa Research

Lack of supply in fringe markets the key to improving conditions

There are also diverging conditions between the smaller markets and CBDs that continue to develop. For some time supply in the fringe has been particularly constrained, tracking at around half the long-term average for over 3 years. At the same time supply in CBD markets has been stronger (but still slightly below average) during the same period, and as a result the non-CBD vacancy rate has fallen below the average CBD rate for the first time in over 10 years.

CHART 5: NET ADDITIONS (SQM)



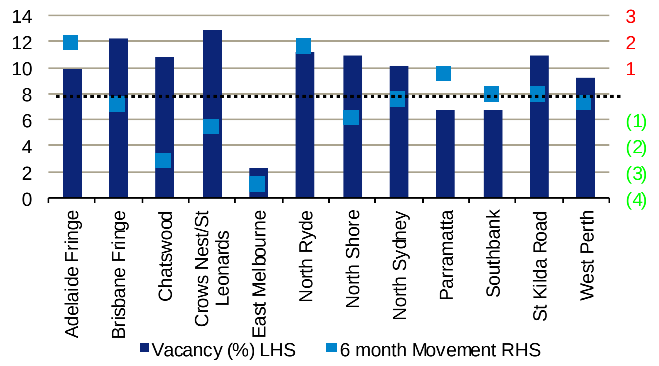
Source: PCA and Investa Research

A note on North Sydney

While the major data providers (the PCA and JLL) both classify North Sydney as a non-CBD market, Investa views North Sydney as another precinct of Sydney CBD in terms of market dynamics. There are several reasons for this. The first is proximity; North Sydney is very close to the CBD, only being separated by the Harbour. Secondly; rental returns and the yield profile of North Sydney correlate very closely to Sydney CBD data over the long-term.

A result of this reduced Fringe supply pipeline there has been a downward bias on national vacancy rate averages compared to the CBD, with most metropolitan markets seeing vacancy rates fall over the period (see Chart 6). However larger tenants are increasingly being forced to relocate to CBD markets in order to gain access to appropriate space – boosting absorption in core locations, a trend we expect to continue.

CHART 6: VACANCY RATES (%)



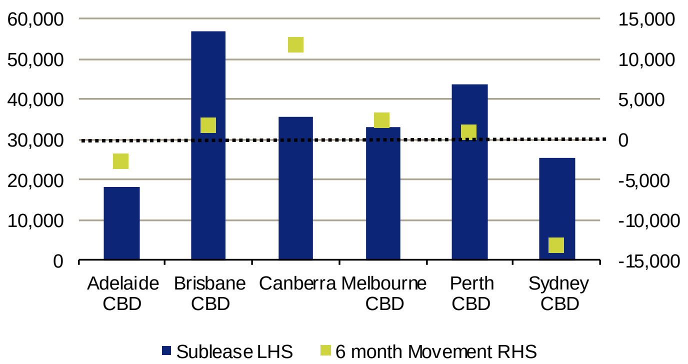
Source: PCA and Investa Research

Sub-lease space remains stable

Over the last 6 months sub-lease space available for lease across the country remained stable. Sydney CBD saw another sharp decline in sub-lease space (-13,500 sqm), and now has sub-lease vacancy well below the long-term average.

Canberra on the other hand saw a spike in sub-lease vacancy (+ 12,000 sqm) as the market is still feeling the pinch of Government contraction.

CHART 7: SUB-LEASE VACANCY AND MOVEMENT (SQM)



Source: PCA and Investa Research

Conclusion

The latest data from the PCA provides further evidence that the major markets of Sydney and Melbourne have entered the recovery phase. Demand has bounced back to near trend levels, in line with our expectations. Other CBD markets are still working through weak demand conditions but we expect that absorption in these locations will escalate as the business cycle continues to improve over the coming periods.

About Investa Research

Investa Research focuses on understanding the drivers and analysing the movements and trends within the Australian commercial office market. The research function is fundamental in guiding group investment strategy and decision making, as well as providing a competitive advantage through insightful analyses and forecasting.

The research team publishes regular updates on the performance of the major Australian office markets, as well as occasional papers and reports examining a broader scope of topics that may be of interest to investors and other Investa stakeholders.

Further information

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About Investa Office

Investa Office is Australia's leading owner and manager of commercial office buildings, controlling assets worth close to $8 billion in key CBD markets across Australia.

Our end-to-end real estate platform incorporates funds, portfolio and asset management, property services, development, sustainability, capital transactions and research. We strive to be the first choice in Australian office, by delivering consistent outperformance for our investors and exceeding the expectations of our tenants and staff.

Investa Office is a global leader in sustainability and is committed to responsible property investment and the ongoing pursuit of sustainable building ownership and management. We are a signatory of the United Nations Principles for Responsible Investment.

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