Vacancy rate increases as net absorption moderates in 1H24

▲ $692/sqm

Prime net face rent (+1.1% q-o-q, +4.8% y-o-y)

▶ 46.4%

Prime incentives (0bps q-o-q, -9 bps y-o-y)

▲ 7.27%

Prime yield (+30 bps y-o-y)

Note: Arrows indicate change from previous quarter.

Key Points

- 2Q24 enquiry volumes continued to rebound from the relatively quiet 4Q23, with total leasing enquiry volume of c.91,600 sqm (+19% q-o-q, -15% y-o-y).
- Gross new leasing volumes above 500 sqm was c.18,200 sqm in 2Q24 which improved significantly from the low level of c.6,200 sqm recorded in 1Q24. Y-o-Y gross lease volumes was up 23% on 2Q23.
- Net absorption for 1H24 was -9,811 sqm (20-year annual average c.21,000 sqm). Prime grade net absorption for 1H24 was -3,300 and secondary grade net absorption was -6,511 sqm.
- Muted net supply for 1H24 of 5,219 sqm as total supply of 39,732 sqm was significantly offset by stock withdrawal of 34,513 sqm. Notable supply additions include the new Capital Square Tower 3 development (13,681 sqm) and refurbishment of QV1 (21,306 sqm).
- Vacancy rate increased 80 bps h-o-h to 15.5% in 1H24 primarily due to the softer net absorption.
- Prime CBD net face rents increased 1.1% q-o-q to $692 (+4.8% y-o-y). Secondary grade net face rents were stable q-o-q (+1.2% y-o-y).
- Muted investment transaction activity with one CBD office transaction. Japan's Yamamoto Realty acquired 181 St Georges Terrace from Charter Hall for $26.5m.
- Prime indicative yields were largely stable q-o-q at an average of 7.27% (+1 bps q-o-q, +30 bps y-o-y). Secondary midpoint yields increased by 4bps q-o-q to an average of 8.04% (+17 bps y-o-y).

FIGURE 1: Summary of Key Indicators

Perth CBD	2Q24	1Q24	2Q23	Q-o-Q Change	Y-o-Y Change
Prime NFR	$692/sqm	$684/sqm	$660/sqm	+1.1%	+4.8%
Incentives	46.4%	46.4%	46.5%	-	-9 bps
Prime NER	$371/sqm	$368/sqm	$354/sqm	+1.1%	+5.0%
Prime Yields	7.27%	7.26%	6.97%	+1 bps	+30 bps

Source: CBRE Research

Economic Overview

Economic growth forecast to continue but growth rate is softening

Having seen a period of strong economic growth spurred by the post-COVID recovery (WA's GSP grew 3.5% in FY23 outperforming national GDP growth of 3.1%), growth is forecast to moderate with the latest state budget papers estimating GSP growth of 1.75% in FY24 and forecasting 2.0% growth in FY25. The economic growth outlook has softened given the restrictive interest rates as well as moderation in commodity prices and population growth from historically high levels seen through 2023. Iron ore prices have eased in recent months over concerns of China's slowing economy but remain above historic averages. Importantly major iron ore miners continue to be very profitable at current prices around US$ 100 per tonne with the unit cost of production of their WA iron ore divisions at approximately US$ 18-24 per tonne (for BHP Group, Rio Tinto and Fortescue Metals Group). Lithium prices are facing an oversupply headwind and as high interest rates have dampened electric vehicle demand, while nickel prices have faced an oversupply issue due to cheap supply coming out of Indonesia. Compared to iron ore though, the contribution of these two commodities to the WA economy is relatively small with nickel accounting for 2% of commodity exports in FY23 and lithium 8%, while iron ore accounted for 49%.

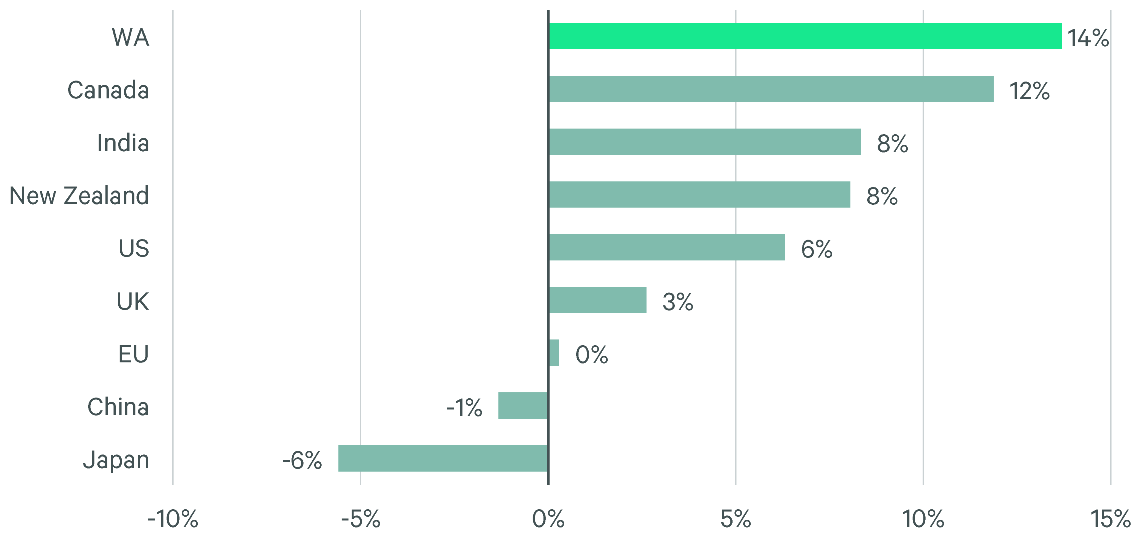
Labour market softening but remains historically strong

The WA labour market has softened slightly from the same time last year (June 2023 unemployment was 3.6%) but continues to remain strong with the unemployment rate at 3.8% as of June 2024 below the national unemployment rate of 4.1% and the 10-year average of 5.3%. WA's workforce participation rate is also amongst the highest nationally at 68.8% compared with 66.9% nationally. Job vacancies have softened by 23% over the past year with 42,000 availabilities as of May 2024 (54,900 at May 2023) but remains 29% above the 10-year average of c.32,500 vacancies.

WA's population growing at the fastest pace nationally

With the strong jobs market here and relatively more affordable housing compared with the major east coast capital cities, WA is attracting strong international and interstate migration with the population growing at the fastest pace nationally. According to the latest data from the ABS, WA's population grew by 3.3% y-o-y in the year to December 2023 compared with the 2.5% growth nationally. Over the past year WA's population grew by c.93,800 persons with 73% coming from international migration, 11% from interstate migration and 16% from natural growth. Looking ahead, while the rate of population growth is forecast to moderate as the Federal Government aims to reduce demand pressure on the housing market, it is expected to be a continued tailwind for the Perth office market over the long term. Deloitte Access Economics forecasts WA's population to grow by 14% cumulatively over the next decade. As highlighted in figure 2, WA's population is forecast to grow amongst the fastest pace on an international level.

FIGURE 2: Cumulative Population Growth Forecast 2023-2033



Source: CBRE Research, Deloitte Access Economics, OECD

Leasing Velocity

Enquiry volumes rebound with deals also improving in Q2

During 2Q24 leasing activity picked up q-o-q (new deals ≥ 500 sqm), with c.18,200 sqm of gross leasing volumes recorded compared with c.6,200 sqm recorded in 1Q24. There were 15 new transactions over 500 sqm recorded in 2Q24 compared with 7 in the prior quarter.

On a y-o-y basis 2Q24 gross new leasing volumes were also higher, being 23% above 2Q23 where c.14,800 sqm was recorded across 11 transactions.

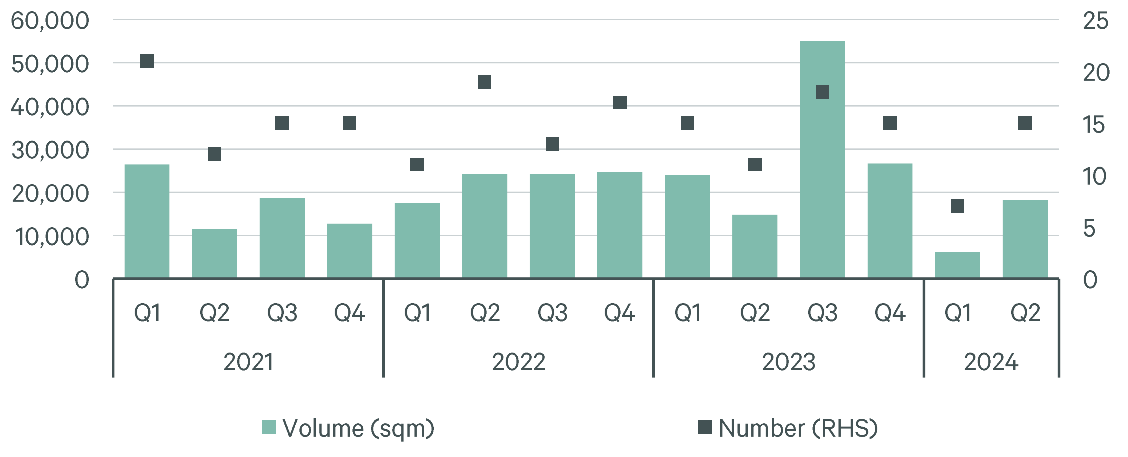
Perth CBD enquiry volumes (CBRE office leasing) across 2Q24 continued to rebound following the soft 4Q23. During 2Q24 gross enquiry volumes was c.91,600 sqm up 19% q-o-q but down 15% y-o-y from the strong 2Q23 volumes. By number of enquiries there was 126 enquiries recorded in 2Q24 which was up 13% q-o-q and up 12% y-o-y.

Perth CBD has experienced a strong flight to quality trend since 2022 and we saw these trends largely continuing through the first half of 2024. Deals in prime grade buildings have accounted for 82% of transactions in 1H24 with B grade accounting for 18% (by number).

By theme, 27% of deals during 1H24 (by number) can be attributed to relocating tenants upgrading to a higher quality building (2023 = 34%), 32% to tenants relocating into the CBD (2023 = 19%), 36% to relocating tenants maintaining the same building quality (2023 = 44%) and only 5% to relocating tenants downgrading their building quality (2023 =3%).

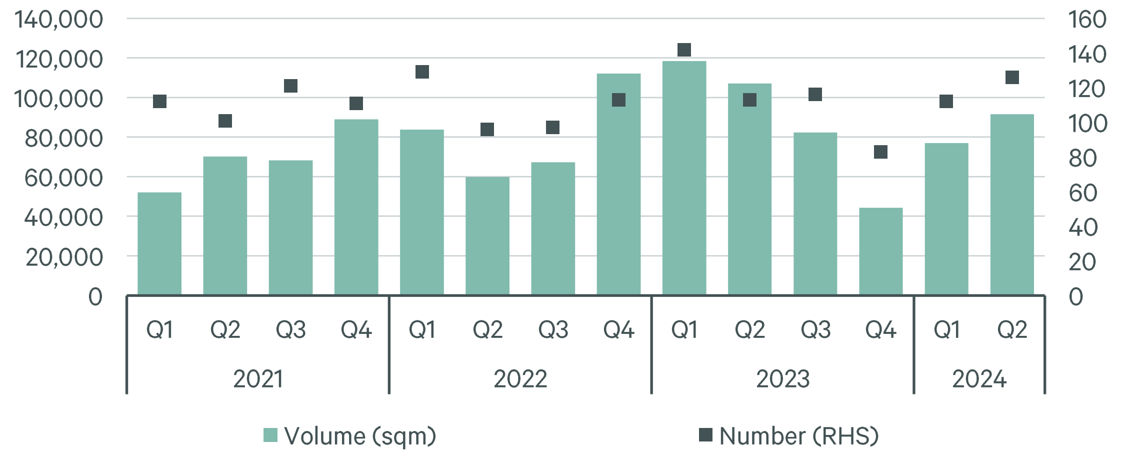
The Perth CBD has seen strong tenant expansion activity in recent years, but expansion activity is slowing from the levels seen the previous two years due to the moderating commodity prices and economic conditions. By sizing requirement, 50% of new deals above 500 sqm were tenants expanding their office footprint (2023 = 73%), 27% maintained their footprint (2023 = 20%) and 23% reduced their footprint (2023 = 7%).

FIGURE 3: Perth CBD leasing volumes, 500+ sqm new deals



Source: CBRE Research

FIGURE 4: Perth CBD CBRE enquiry volumes



Source: CBRE Research

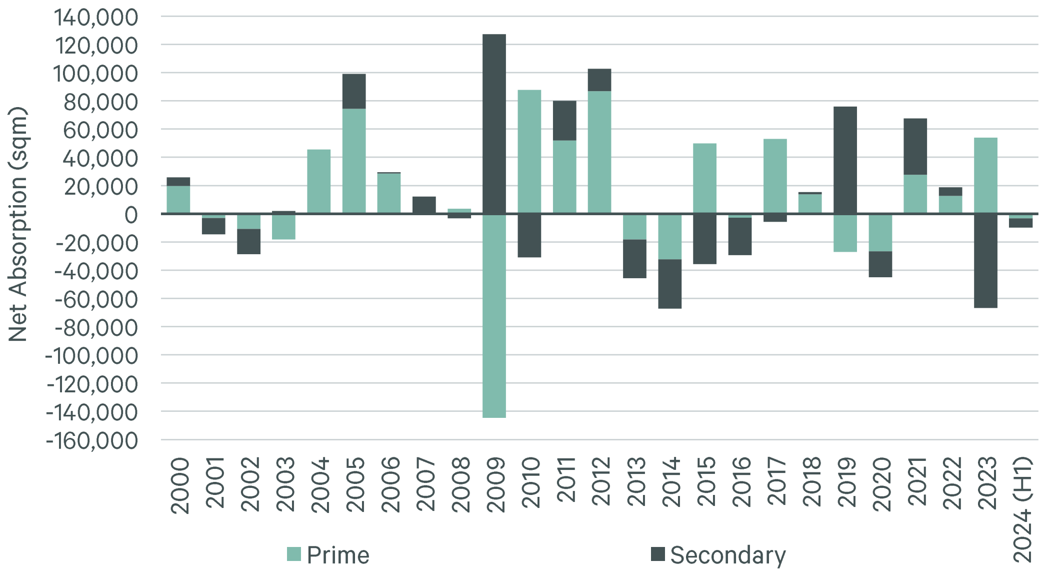
Net Absorption

1H24 net absorption moderates as tenant expansion activity slows

Net absorption recorded for the first half of 2024 was -9,811 sqm (20-year annual average c.21,000 sqm). With the moderating economic growth and commodity prices, tenant expansion activity has slowed in 1H24 contributing to the negative net absorption for the half year.

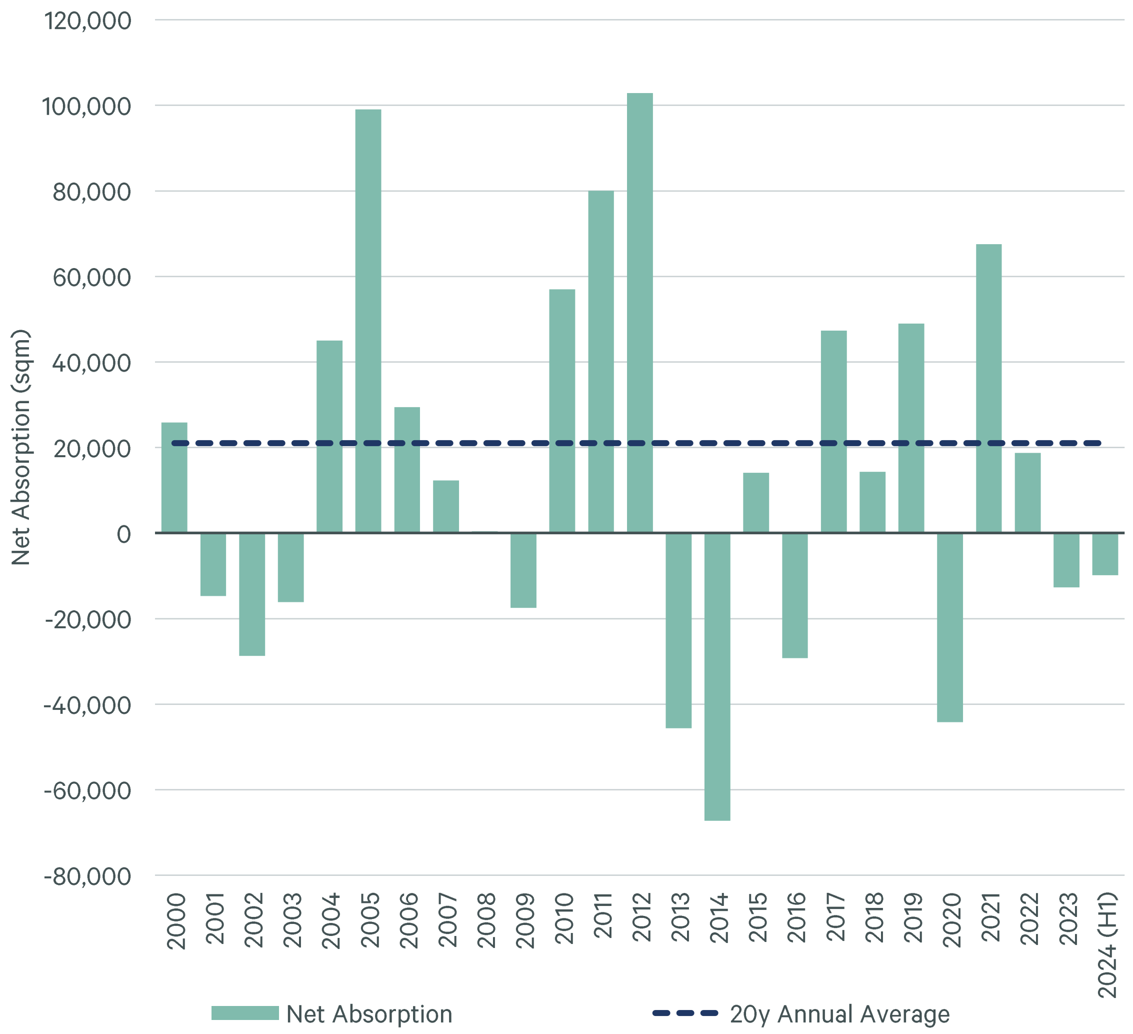
Net absorption across all building grades came in softer during 1H24. Premium grade and A grade recorded net absorption was -2,009 sqm and -1,291 sqm respectively during the half year. Total prime grade (premium and A grade) was -3,300 sqm (20-year annual average c.17,000 sqm). Total net absorption for the secondary grade was softer than the prime grade at -6,511 sqm for the half year (20-year annual average c.8,000 sqm).

FIGURE 5: Perth CBD Historical Prime vs Secondary Net Absorption



Source: Property Council of Australia, CBRE Research

FIGURE 6: Perth CBD Historical Net Absorption



Source: Property Council of Australia, CBRE Research

Supply

Capital Square 3 development and QV1 refurbishment enters market

Total supply added to the market during 1H24 was 39,732 sqm, comprising of the completion of the new Capital Square Tower 3 development (13,681 sqm), refurbishment of QV1 (21,306 sqm), refurbishment of 186 St Georges Terrace (3,920 sqm) and refurbishment of 306 Murray Street (825 sqm).

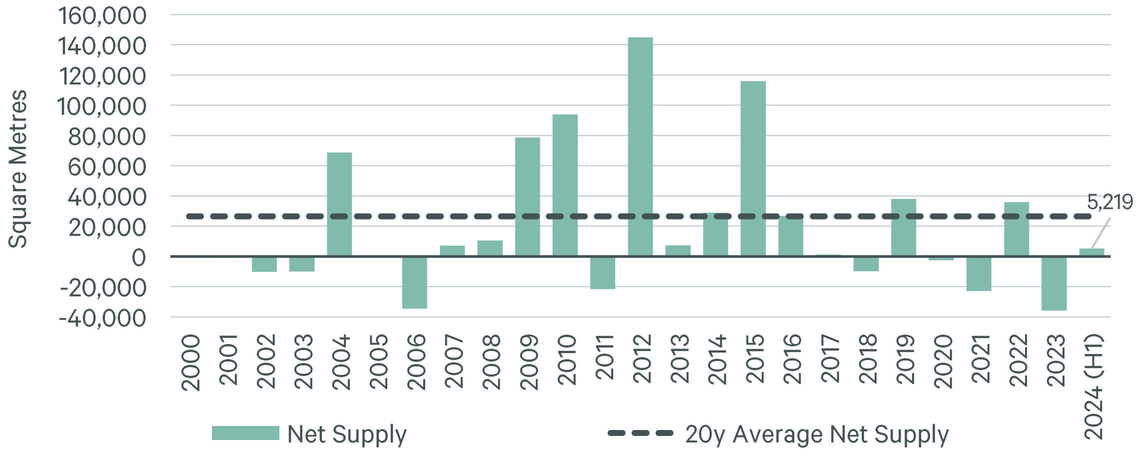
Net supply during 1H24 was relatively muted at 5,219 sqm (20-year annual average c.26,500 sqm), as 34,513 sqm of stock withdrawals offset a large portion of the total supply. Stock removed from the market largely related to withdrawal of 256 St Georges Terrace for refurbishment (22,530 sqm), withdrawal of 100 St Georges Terrace for refurbishment (6,200 sqm) and withdrawal of 641 Wellington Street (2,760 sqm).

Supply gap has emerged between 2026-2029

Looking ahead the scheduled supply amounts to c.70,000 sqm (exc. mooted developments) which is 4% of current stock levels. Nine The Esplanade (33,000 sqm) is the only new development currently under construction and scheduled to complete in early 2025. Approximately half of the office space at Nine the Esplanade has been pre-committed. Refurbishments total c.30,000 sqm, comprising 256 St Georges Terrace which was withdrawn in 1H24 and 100 St Georges Terrace, both of which are expected to be completed in 2H24.

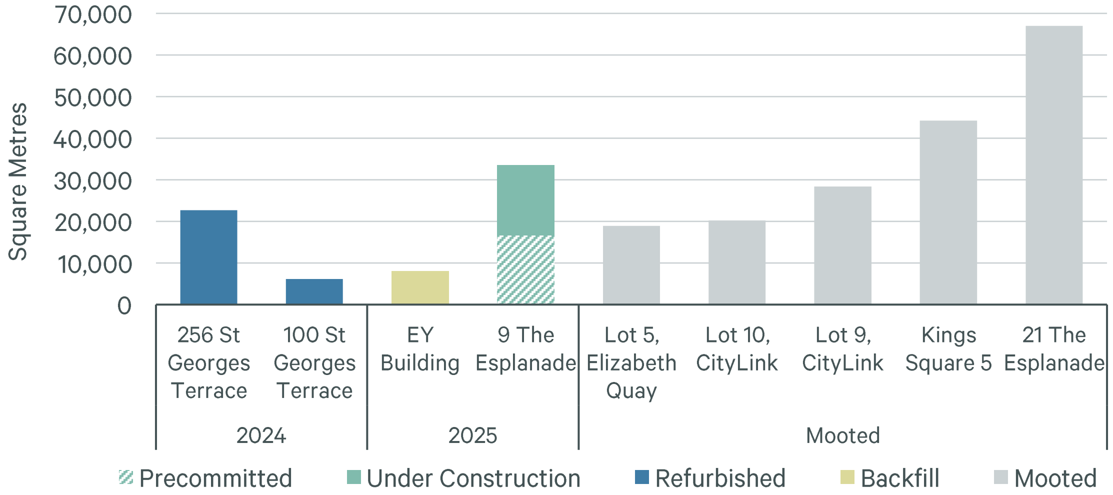
Looking beyond 2025 a supply gap has emerged for the Perth CBD between 2026-29. Due to the high construction cost environment no new developments are currently committed to. Looking at the mooted projects, Lot 5 Elizabeth Quay and 21 The Esplanade have the highest likelihood of proceeding to construction in the foreseeable future. Should these proceed to construction, completion is not likely before the end of 2029 which has therefore created the supply gap for new developments between 2026-29.

Figure 7: Perth CBD Historic Net Supply



Source: Property Council of Australia, CBRE Research

FIGURE 8: Perth CBD Supply Pipeline



Source: CBRE Research
To note: new developments/refurbishments > 4,000 sqm and backfill supply > 8,000 sqm.
Mooted developments only include those that at the time are mostly likely to proceed.

Market Vacancy

Market vacancy rises due to softer net absorption and positive net supply

The market vacancy rate in the Perth CBD increased 80 bps h-o-h to 15.5% in 1H24. This was due to a combination of softer net absorption of -9,811 sqm and net supply of 5,219 sqm in 1H24. The market vacancy rate was positively impacted in the prior half (2H23) due to net withdrawal of 69,005 sqm primarily related to withdrawal of secondary grade stock in the eastern part of the CBD following Property Council of Australia's boundary change.

Vacancy rate for the premium grade increased 470 bps h-o-h to 12.5% primarily due to net supply of 21,306 sqm (QV1) for the half and muted net absorption of -2,009 sqm. A grade vacancy declined 170 bps h-o-h to 13.9% primarily due to net stock withdrawal of 15,049 sqm, as net absorption was negligible at -1,291 sqm for the half.

Overall Prime grade vacancy rose 80 bps h-o-h to 13.3% in 1H24 with net absorption of -3,300 sqm and net supply of 6,257 sqm in the half. Secondary grade vacancy rose 90 bps h-o-h primarily due to net absorption of -6,511 sqm in 1H24.

Perth sublease space remains below historical average

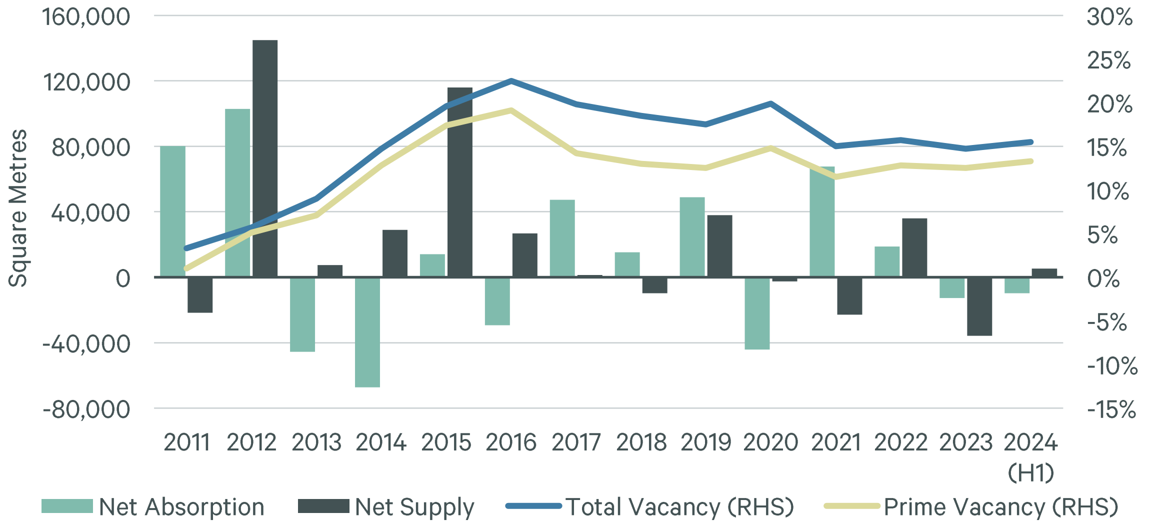
Sublease availability in the Perth CBD remains at historically low levels. As of 2Q24 there was 7,390 sqm of vacant sublease space on the market as per CBRE's 2Q24 sublease tracker, a decrease of c.1,700 sqm q-o-q and largely stable on a y-o-y basis. Sublease availability remains below the 10-year average of c.40,000 sqm. Of the 7,390 sqm of available sublease space, c.60% is due to tenants reducing their office footprint and c.40% due to tenants re-locating/ consolidating their office footprint due to M&A activity.

FIGURE 9: Summary of Perth CBD Office Market

Market/ Grade	Stock (sqm)	Net Absorption 6 months (sqm)	Net Absorption 12 months (sqm)	Net Supply/ (Withdrawal) 6 months (sqm)	Net Supply/ (Withdrawal) 12 months (sqm)	Vacancy % Jun 24	Vacancy % Dec 23
Prime	1,128,171	-3,300	30,722	6,257	41,246	13.3%	12.5%
Secondary	647,994	-6,511	-77,190	-1,038	-105,032	19.3%	18.4%
Total	**1,776,165**	**-9,811**	**-46,468**	**5,219**	**-63,786**	**15.5%**	**14.7%**

Source: Property Council of Australia, CBRE Research
Note: 12-month figures are impacted by the Perth CBD boundary change implemented by PCA in the December 2023 half year.

FIGURE 10: Perth CBD Office Market Balance



Source: Property Council of Australia, CBRE Research

Rental Performance

Prime grade rents continue growing as secondary grade slows

Prime grade net face rents increased 1.1% q-o-q and 4.8% y-o-y to $692/sqm while secondary grade net face rents remained stable q-o-q at $461/sqm (+1.2% y-o-y).

Having seen a robust economy and healthy office market fundamentals, Perth's CBD office market has experienced strong rental growth in recent years, albeit growth has been slowing in recent quarters particularly for secondary grade assets as economic and market conditions have softened.

With the flight to quality trend evident in the Perth CBD market and tighter vacancy than the secondary grade market, prime grade face rents have continued to grow during 2Q24. High fit out costs in Perth and strong demand from tenants for fitted space, particularly for deals less than 500 sqm has also been contributing to prime grade rent growth. This has driven face rent growth in A grade buildings with landlords increasing their face rents to offset high fit out cost incentives.

Incentives hold steady after tightening in 2023

During 2Q24 prime grade incentives remained stable q-o-q averaging 46.4% (-9 bps y-o-y). Having peaked recently at 50.8% in 1Q22, prime grade incentives have been on a downtrend given the stronger demand for higher quality stock in the market. However, the trend of declining incentives has moderated in recent quarters with prime grade incentives holding steady at 46.4% for the past three quarters. Looking ahead prime grade incentives are expected to remain steady around current levels in the near term.

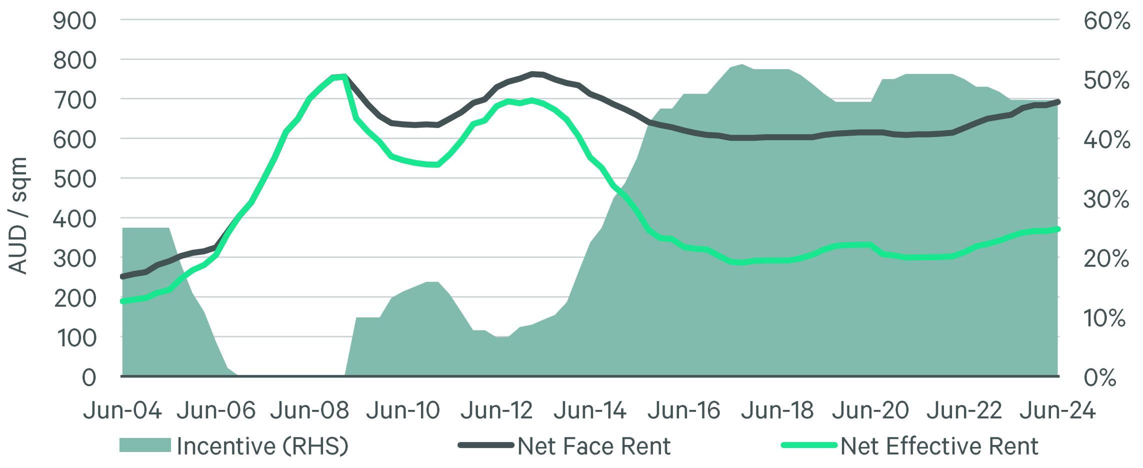
Secondary grade incentives were also steady q-o-q averaging 52.1% (-42 bps y-o-y) in 2Q24. Secondary grade incentives have also declined but to a lesser extent, having recently peaked at 55% in 3Q22.

FIGURE 11: Perth CBD Rent and Incentives by Grade

Perth CBD	Net Face Rent (AUD/sqm)			Incentive (%)			Net Effective Rent (AUD/sqm)		
	2Q24	Q-o-Q Change	Y-o-Y Change	2Q24	Q-o-Q Change	Y-o-Y Change	2Q24	Q-o-Q Change	Y-o-Y Change
Premium	767	+1.3%	+3.6%	44.8%	Stable	-17 bps	423	+1.3%	+3.9%
A+ Grade	688	+0.3%	+5.8%	44.4%	Stable	-10 bps	382	+0.3%	+6.0%
A Grade	621	+1.8%	+5.4%	50.0%	Stable	Stable	311	+1.8%	+5.4%
Average Prime Grade	**692**	**+1.1%**	**+4.8%**	**46.4%**	**Stable**	**-9bps**	**371**	**+1.1%**	**+5.0%**
B Grade	461	Stable	+1.2%	52.1%	Stable	-42bps	221	Stable	+2.1%

Source: CBRE Research

FIGURE 12: Perth CBD Historic Prime Grade Rent and Incentives



Source: CBRE Research

Investment Market

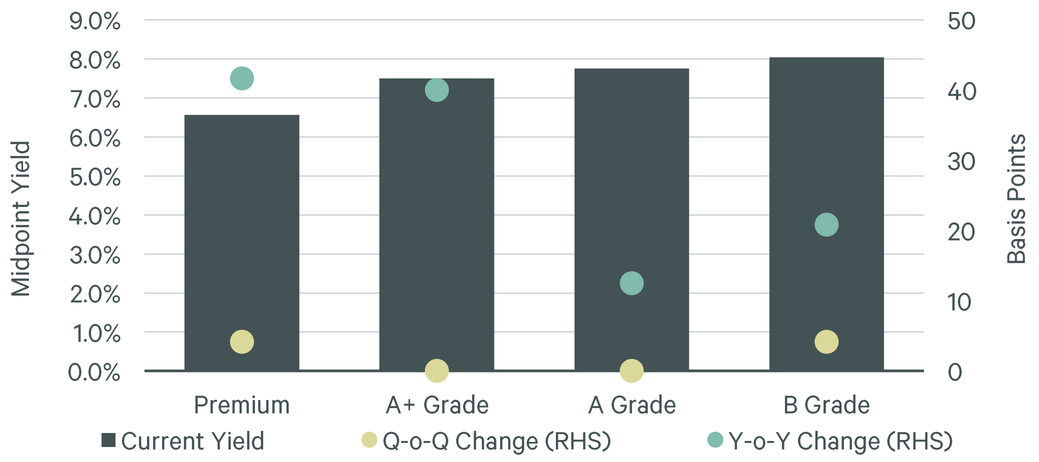
Muted transaction activity but positive early signs of improved office interest

While investment transactions across Perth's retail, industrial and living sectors has picked up in 2024, transaction activity in the Perth CBD office market has remained muted. Through the first half of 2024 one office asset transacted in the Perth CBD as Japan's Yamamoto Realty acquired 181 St Georges Terrace, a seven storey B grade asset from Charter Hall for $26.5 million.

However, with the re-rating that has occurred in prices/capitalisation rates over the past 24 months, there are early positive signs of capital/interest flowing back to the office sector with investment transaction activity in the Eastern states office market picking up recently and a number Perth CBD office assets currently under due diligence.

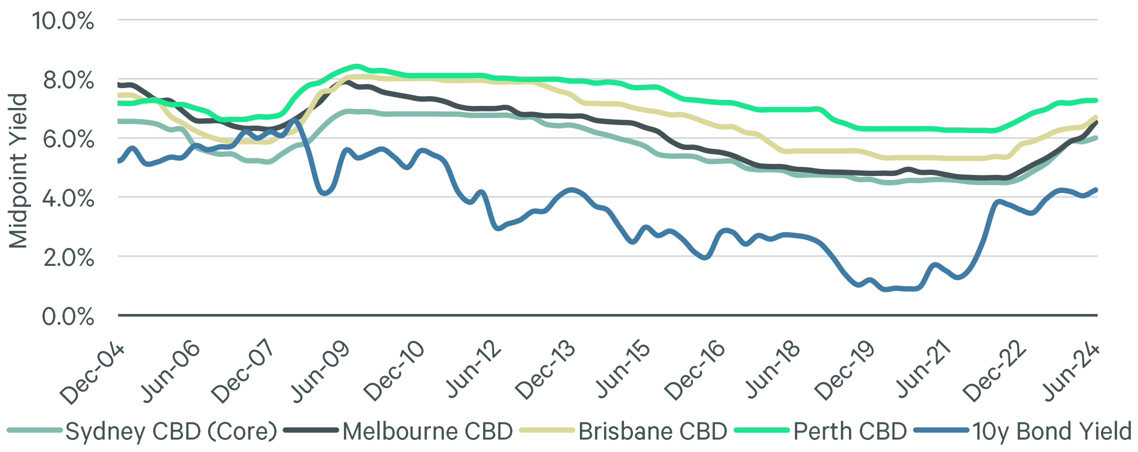
During 2Q24 Perth CBD prime office midpoint yields were largely stable q-o-q at 7.27% (+30 bps y-o-y). Secondary grade CBD midpoint yields increased marginally by 4bps q-o-q to 8.04% (+17bps y-o-y).

FIGURE 13: Perth CBD Office Yields By Grade and Change



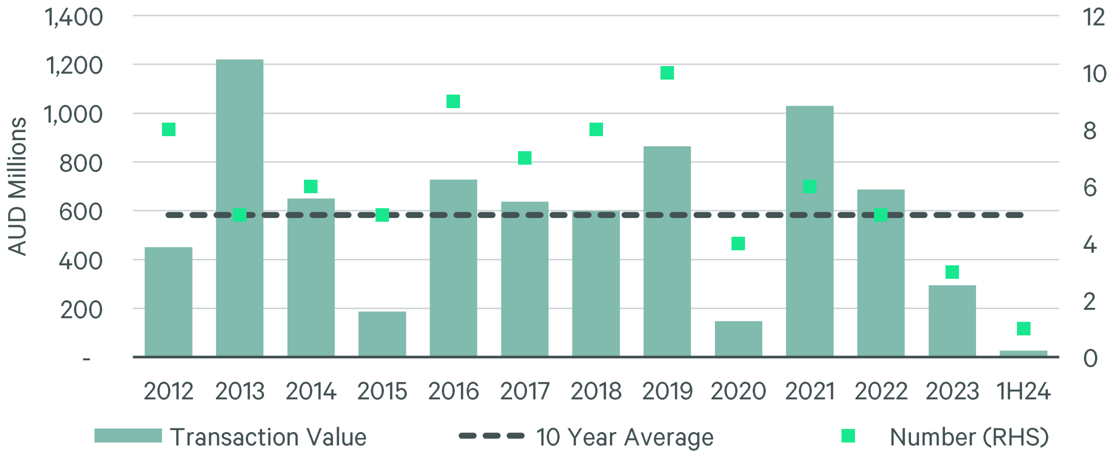
Source: CBRE Research

FIGURE 14: Australian CBD Markets Prime Yield



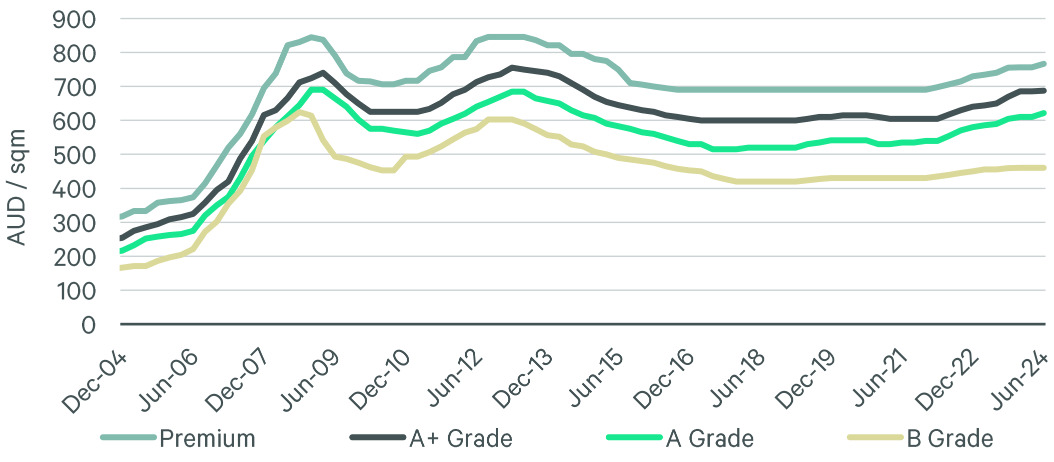
Source: CBRE Research

FIGURE 15: Perth CBD Office Sales (greater than AUD 5 million)



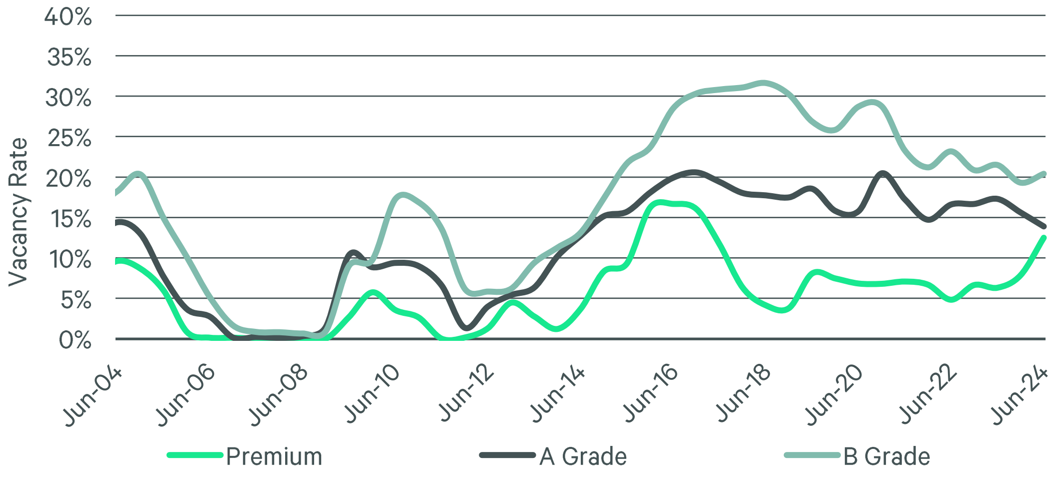
Source: CBRE Research

FIGURE 16: Perth CBD Net Face Rents By Grade



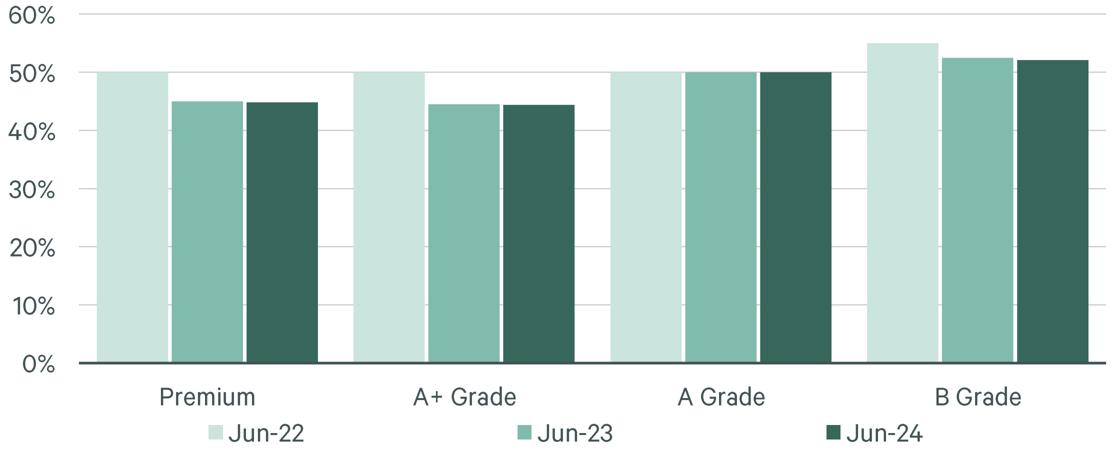
Source: CBRE Research

FIGURE 17: Perth CBD Vacancy Rate By Grade



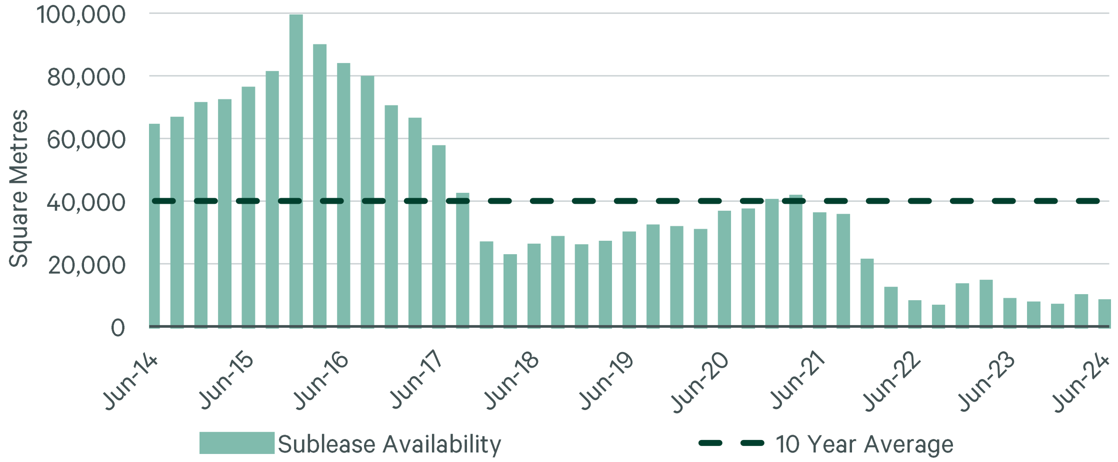
Source: Property Council of Australia, CBRE Research

FIGURE 18: Perth CBD Incentives By Grade



Source: CBRE Research

FIGURE 19: Perth CBD Sublease Availability



Source: CBRE Research

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