PERTH OFFICE OUTLOOK

MAY 2022

CUSHMAN & WAKEFIELD

OPENING STATEMENT

The Perth office market looks set for growth after several years of relatively soft tenant demand which contributed to high vacancy, weak rental growth, and high incentives.

Market conditions have since recovered with the potential for solid demand growth in 2022 supported by Western Australia's (WA) dominant mining sector being buoyed by booming commodity prices, strong economic growth, and Perth's relatively low COVID impact.

The following reviews current trends in the Perth CBD office market, the relationship with the resources sector, key trends in indicators of tenant demand and the potential future market outlook.

EXECUTIVE SUMMARY

The Perth commercial real estate market is currently in a stable position, experiencing slow but steady growth. Unlike the rest of the country, WA avoided re-occurring cycles of COVID waves and extended lockdown that accompanied flareups in infection rates. This has led to the economy of WA being safeguarded from the worst of the effects of the pandemic and allowed for an accelerated pace of recovery that has been the strongest of all the states, displaying 5.7% GDP growth since the start of the pandemic in January 2020 to July 2021.

Data to December 2021 shows that the national economy expanded 3.4% in Q4 after contracting 1.9% in Q3 due to the aforementioned lockdowns, with WA being ranked first in economic growth in Q4 of 2021. Overall GDP grew 4.2% over the calendar year and is predicted to continue steady growth if slightly slower in 2023. Strong growth indicators such as these should be pointing toward an increase in investment and the return of the full-strength labour force, however, supply chain issues, concerns about future COVID variants and serious labour shortages hampering business confidence, it is likely that the predicted aggressive rebound growth will be somewhat dampened.

DEMAND INDICATORS AND MARKET PREDICTIONS

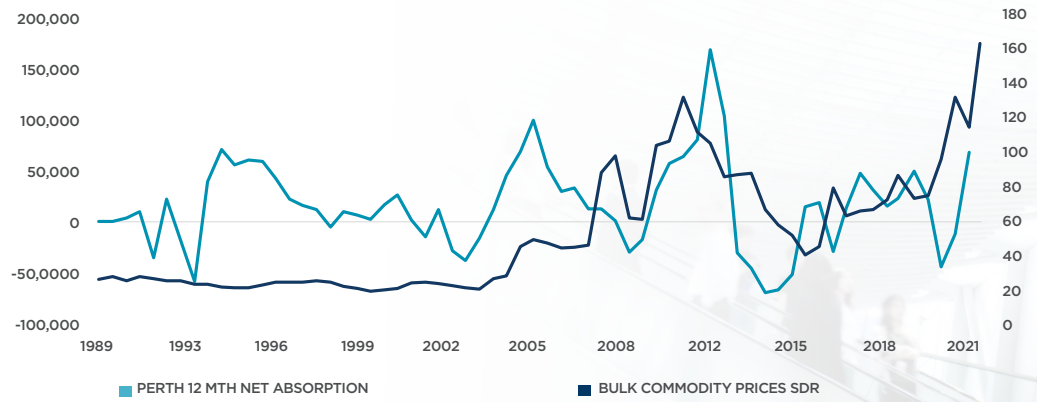
As a large portion of the Western Australian economy relies on natural resources, with mining comprising of 47% of the state's economy, commodity prices and the mining industry play large roles to influence the office market. Mining booms and increases in commodity prices historically ramp up the office market with tenants absorbing more office space and employing a larger workforce. Indicators such as bulk commodity prices and engineering job vacancies growth both tend to correlate with the markets 12-month net absorption levels.

The RBA's index of bulk commodity prices has risen by 41.5% in the past 12 months to April this year. Following Russia's invasion of Ukraine, reaching a historic high of 164.5 SDR value in April, and a record high 12-month average of 127.4.

These commodity price figures align with the increase in 12-month net absorption that the office market experienced throughout 2021 of over 67,000sqm, further highlighting the Perth office markets relationship to the mining industry.

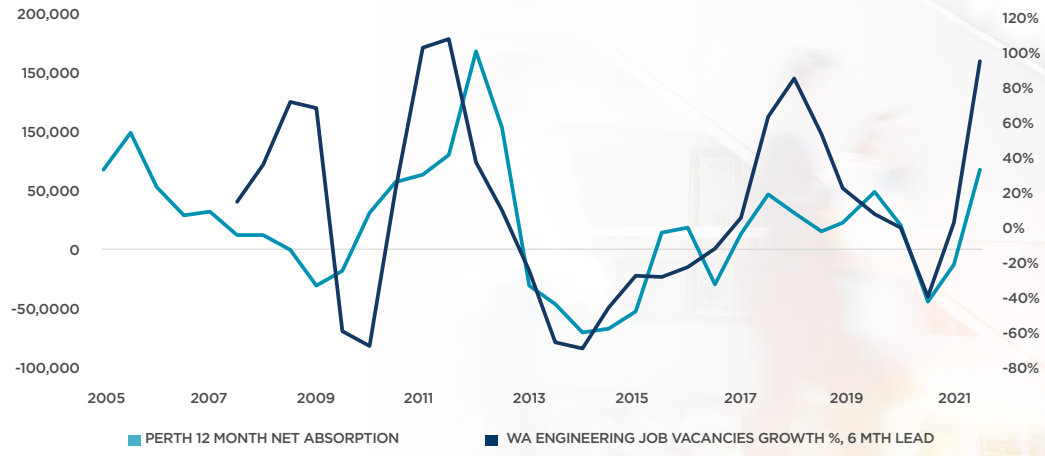
As we have seen office market recovery and growth due to 2021 commodity prices, forward looking indicators for 2022 suggest an increase in investment activity. Growth is expected to accelerate to 7.75% in 2022-2023. A key risk with WA's reliance on a robust mining market is its lack of diversity for the rest of the economy. If left unaddressed, this could affect the overall commercial real estate market in the long term.

FIGURE 1 - COMMODITY PRICES AND OFFICE DEMAND



(SOURCE: RBA INDEX OF COMMODITY PRICES AND PCA OFFICE MARKET REPORT)

FIGURE 2 - STATE ENGINEERING JOB VACANCIES AND OFFICE DEMAND



(SOURCE: AUSTRALIAN GOVERNMENT LABOUR MARKET INFORMATION PORTAL AND PCA OFFICE MARKET REPORT)

OFFICE NET ABSORPTION, DIRECT ENQUIRIES AND PUBLIC BRIEFS

WA has seen a steady office vacancy decline since the height of the pandemic in December 2020 of 19.9%, reducing to 16.8% in July 21, and now 15% as at January 2022, according to the Property Council of Australia's (PCA) Office Market Report. Perth has already returned to pre-pandemic vacancy levels. The Cushman & Wakefield Perth leasing team has noted that rents and incentives have not had much of a significant change since recovering from the pandemic due to an increase in market competition.

Due to the strong level of economic activity in WA, the office market has experienced steady demand and the highest in the nation for 2021, with a 12-month net absorption at +67,550 sqm. Mark Clapham, the Joint Managing Director of Cushman & Wakefield Perth, Western Australia had this to comment on the current market:

"Demand for office space in the sub-2,000sqm size range across both CBD and Metropolitan office markets has been strong over the 1st quarter of 2022, naturally this will continue to provide a solid positive take-up of office space in existing office space across the Premium and A grade quality grades over the short to medium term.

Larger shadow vacancies in the Premium Grade sector contributing to supply increases such as Chevron's tenancy in QV1 and their upcoming relocation to their new corporate headquarters at Elizabeth Quay in 2023, will likely dampen any net absorptions gains made over the short term.

On the new development front, a limited pool of sizeable tenants to pre-commit to new larger office developments is forcing developers to secure multiple precommitments to activate construction, this alone will limit the number of new office buildings coming out of the ground. Coupled with this and just as importantly the current rising rates of inflation and rapidly rising costs of construction have put upward pressure on economic rents, this is yet to play out in the market but rising economic rents may begin to limit tenant demand for new office developments over the short to medium term."

With current Q1 22 Cushman & Wakefield active tenants and leasing enquiries for the quarter reaching above 2021 quarterly average levels, showing positive signs of steady growth and activity. As 12-month net absorption can be used as a proxy indicator for market demand, we can expect steady growth following Q1 2022.

CONSUMER & BUSINESS CONFIDENCE, COVID-19, LABOUR MARKET AND SUPPLY CHAINS

The WA hard border opening on 3 March allowed the spread of the Omicron variant throughout the community affecting business and consumer confidence. The Chamber of Commerce and Industry WA Business Confidence Survey has shown that both long and short-term business confidence indexes are down 14.6 and 8.1 index points in the first quarter of 2022, with short-term confidence remaining above pre-pandemic levels. Business confidence was also hindered by supply chain disruptions due to high demand for goods in 2021 against an inflexible supply side which caused bottlenecks and gridlocks in the global shipping and logistics industry, which in turn resulted in higher costs in shipping, raw materials, and extended delivery times.

Since the height of the pandemic, WA’s unemployment rate has experienced a decline from 8.5% in June 2020, to 3.4% in December 2021. With the lowest unemployment rate in the nation, and the lowest rate recorded in the state for 13 years, we are experiencing an intensified skilled labour shortage. Hard border closures have prevented skilled migration entering the state through domestic and international sources, as well as labour associated with international students. According to the quarterly CCIWA Business Confidence Survey, 4 out of 5 (81%) businesses see the skilled labour shortage as a barrier to their growth. The resources sector is most affected, with 9 out of 10 (93%) businesses also citing the skilled labour shortage. With the WA border re-opening we can expect demand for office space to remain strong in the short-term boosted by labour migration and employment growth with large mining companies set to move first in attracting talent.

CONCLUSION

As Western Australia moves past the peak of its Omicron infection wave and borders opening to the rest of the nation and the world in Q1 2022, the overall outlook for the economy and commercial real estate market is looking positive for the short-term.

Market conditions have significantly improved since the beginning of the pandemic. Lower vacancy rates, higher 12-month net absorption levels, steady market activity, low unemployment rates and historic high commodity prices are all combining to provide WA with steady growth in 2022-2023. Some risks remain for both the real estate and mining industry however, with an ongoing skilled labour shortage, subdued business confidence, international trade disputes, a lack of economic diversification and disruptions to global supply chains.

The strong indicators of demand suggest that in 2022 Perth may experience the strongest net absorption it's ever seen in years, this should contribute to lower vacancy and falling incentives.

However, the rise in flexible working combined with economic and geopolitical uncertainty may temper the demand recovery.

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