RESEARCH

Knight Frank

BRISBANE FRINGE OVERVIEW

LIMITED NEAR TERM SUPPLY SUPPORTS RENTAL GROWTH

JUNE 2019

NO NEW SUPPLY IN 2019 | SOLID RENTAL GROWTH | DOMESTIC FUNDS ACTIVE

KEY FINDINGS

Accelerating positive net absorption will outweigh the return of refurbished stock, leading to a **fall in total vacancy to 14.0% in mid-2019.**

Prime effective rents grew by **8.2%** in the year to April 2019 as large prime contiguous vacancies diminished. Secondary rents are lagging however positive, with 3.4% effective growth y-o-y.

New supply will be **limited in the short term** with no buildings currently under construction. This is expected to **change in the next year** as there are a number of proposals seeking to achieve required pre-commitment levels.

The **recent falls** in long term and short term interest rates will **support further yield tightening** across the market.

Major Brisbane Projects:
- Cross River Rail $5.6b
- Brisbane Metro c$1.0b
- M1 Upgrade $1.0b
- Second Runway $1.4b
- Queens Wharf c$3.6b
- Herston Quarter $1.1b

JENNELLE WILSON
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ECONOMIC OVERVIEW

Economic growth will be consolidated over the coming years with Queensland and Brisbane to outperform the southern states due to population growth, infrastructure investment and exposure to export industries.

Queensland economic growth set to outpace Vic and NSW over the next 5 yrs

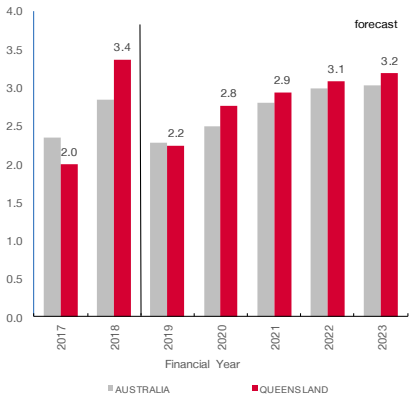
Aligned with national and global trends, Queensland's economic growth is likely to moderate in FY19 and beyond with the FY18 result of 3.4% growth likely to form the peak for the medium term. Forecast growth of 2.2% for FY19 will be followed by steady increases as shown in Figure 1 (Oxford Economics). The Oxford Economics forecasts show a change in the guard for the growth states with Queensland (14.2%) and WA (20.8%) recording higher GSP cumulative 5 year growth FY19-FY23 than the recent engine rooms of NSW (10.8%) and Victoria (13.8%).

Employment to benefit

Brisbane employment within core office industries is estimated to grow by 5.73% during FY19 (Oxford Economics), which has assisted to accelerate recent demand. Expectations are lower going forward, however remain positive with average annual growth of 1.95% p.a. through to FY23. Figure 2 indicates the source of this 5 year demand with public administration and professional and technical services dominant.

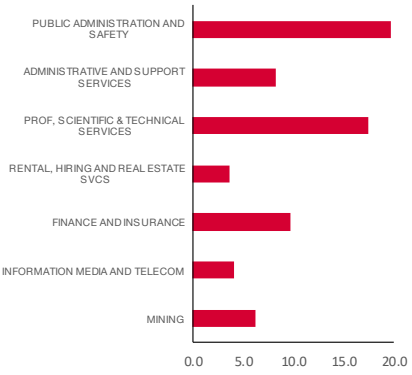
The recent reduction in the cash rate will continue to support a lower AUD, benefitting exporting sectors of mining/ energy and education, both having significant representation in the Fringe.

FIGURE 1
Economic Growth
%yoy GSP (Qld) and GDP (Aust) growth



Source: Oxford Economics/Knight Frank Research

FIGURE 2
Brisbane Core Office Industries
'000 FY19-FY 23 total increase in employment



Source: Oxford Economics/Knight Frank Research

TABLE 1
Brisbane Fringe Office Market Indicators as at Q2 2019

Grade	Total Stock (m²)^	Vacancy Rate (%)^	Annual Net Absorption (m²)^	Annual Net Additions (m²)^	Average Gross Face Rent ($/m²)	Average Incentive (%)	Average Core Market Yield (%)*
Prime	663,924	15.0	-11,565	4,201	585	36.0	6.03
Secondary	541,371	14.4	-2,917	-6,066	474	38.0	7.55
Total	**1,205,295**	**14.8**	**-8,648**	**-1,865**			

Source: Knight Frank Research/PCA ^ as at January 2019 *assumed WALE 4-6 years prime, 2-5 years secondary

TENANT DEMAND & ABSORPTION

Engineering, IT and Construction dominate leasing activity

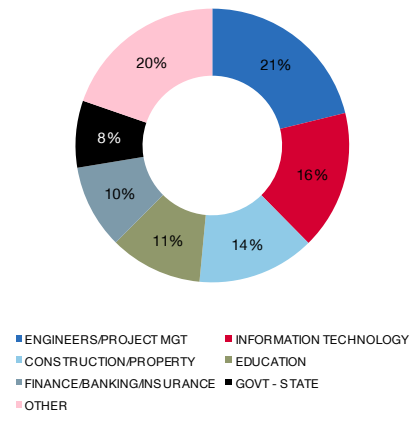
More than half of recent leasing activity has come from the sectors of Engineering, Information Technology and Construction/ Property. Analysis of lease deals during 2018 and 2019 ytd, tracked by Knight Frank, shows Engineers accounted for 21% of leasing activity by area (Figure 3). This was dominated by tenants such as Downer (7,137sqm), WSP (5,685sqm) and Sandvik (2,931sqm).

There has been sustained leasing activity in the Fringe market from Information Technology tenants with DXC (4,000sqm), RPS (2,254sqm), Jacques Technology (1,214sqm), Opengear (1,154sqm), SporsoredLinx (1,491sqm), Genie Solutions (1,255sqm) and Neto (1,700sqm) all active over the past year.

Activity from the Construction/Property sector was underpinned by the CPB Consortium lease of 8,070sqm in Milton, with the winning bidder for the Cross River Rail project relocating into the former Origin space.

Based on current and expected briefs to the market the Finance and Insurance sector will be active over the next year with IAG (5,000sqm) yet to determine their future space and Sunsuper expected to release a brief for 15,000sqm of space imminently. Construction tenants will remain in focus with both Boral (2,100sqm) and Seymour White (1,500sqm) seeking space.

FIGURE 3
Brisbane Fringe Leasing Activity
2018 & 2019ytd by tenant type



Source: Knight Frank Research

Net Absorption & Outlook

Prime	CY18: -11,565sqm	↑
Secondary	CY18: -2,917sqm	→

Source: Knight Frank Research/PCA

Net absorption will remain positive and increase during 2019

The welcome return to positive net absorption for the Fringe market in H2 2018 is expected to be consolidated in the results for H1 2019.

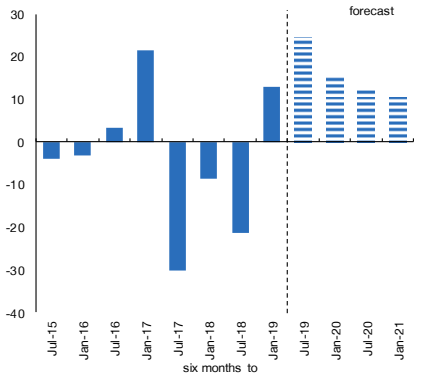
Recently there have been strong inflows into the Fringe market from tenants such as WSP (5,685sqm), Southern Cross (3,623sqm), DXC (4,000sqm), Downer Defence (2,500sqm), Ladbrokes (2,000sqm) and CPB Consortium (8,070sqm) which were either new to the Fringe market or consolidations including significant inflow from other precincts.

The net absorption in the first half of 2019 is forecast to represent double the levels seen in H2 2018 at 24,500sqm. Some of this is attributed to a catch up with much of the increased activity of late 2018 not captured until tenants physically relocated in the new year. However there has been steady take-up activity throughout the year with tenants new to the market a welcome boost.

Balance between CBD and Fringe market restored

The trend of the Fringe losing tenants to the CBD turned around during 2018. The general trend of tenants moving markets to go to new space is back in place. Aurecon moved from the CBD into new space as did WSP, while Sun Water flowed out of the CBD into existing A grade Fringe space.

FIGURE 4
Brisbane Fringe Net Absorption
('000sqm) per 6 month period



Source: Knight Frank Research/PCA

With only refurbished stock to enter the market during 2019 the draw for CBD tenants to relocate to the Fringe is expected to be modest. However tenant mobility as a whole appears to remain high with tenants likely to move to consolidate and/or allow for refreshed fitout and space planning.

Resource and infrastructure spending and confidence boosting demand

The solid employment forecasts, increased infrastructure and major project expenditure plus the uptick in activity within the energy and mining sectors are providing confidence to many business types frequently found in the Fringe market (ie engineering, project management/construction).

As such the Fringe market is expected to continue to benefit from this increased tenant activity. After the spike in net absorption during H1 2019, net absorption is forecast to remain solid ranging from 11,000sqm to 15,250sqm per six month period, through to the end of 2021.

SUPPLY & DEVELOPMENT

Vacancy Rate & Outlook

Prime	15.0% +230bps y-o-y	⇩
Secondary	14.4% -60bps y-o-y	⇨

Source: Knight Frank Research/PCA Jan 2019

Vacancy set to fall with improved take-up and modest supply

The vacancy rate increased slightly to 14.8% as at the January 2019 PCA survey with the positive net absorption not quite covering the new supply added into the market from 25 King St, Bowen Hills. This is expected to reverse to the mid-year with a reduction to 14% total vacancy expected as the stronger take-up flows through to the vacancy figures.

The Inner South remains the precinct with the lowest vacancy rate at 10.0%, albeit higher than the 9.2% in mid-2018. While the prime buildings along Grey Street have remained in demand there was negative net absorption across the precinct of –16,426 sqm in 2018.

New supply, which was only partially pre-committed, resulted in the vacancy increasing in the Urban Renewal precinct to 14.2% in January 2019.

TABLE 2

Brisbane Fringe—Vacancy Rates

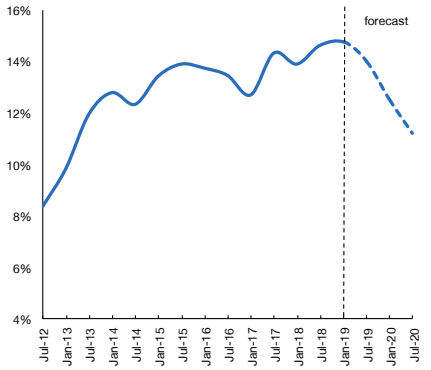
Precinct	Jan 18	Jan 19
A Grade	12.7%	15.0%
Prime	**12.7%**	**15.0%**
B Grade	14.0%	13.5%
C Grade	16.2%	14.4%
D Grade	50.9%	58.2%
Secondary	**15.0%**	**14.4%**
Milton	17.1%	21.5%
Urban Renewal	14.3%	14.2%
Spring Hill	17.6%	17.0%
Toowong	11.9%	11.4%
Inner South	9.3%	10.0%
Total	**13.9%**	**14.8%**

Source: Knight Frank Research/PCA

FIGURE 5

Brisbane Fringe Vacancy

% total vacancy



Source: Knight Frank Research/PCA

After being the focus of new supply during 2018, with 33,400sqm of additions, the Urban Renewal precinct has had by far the strongest net absorption of the Fringe precincts at 27,604sqm for 2018. This has continued into 2019 with take-up in excess of 10,000sqm in H1 and this is expected to be consolidated with the mooted lease of two floors to WeWork in 25 King St.

Vacancy in Spring Hill was 17.0% as a result of largely stagnant net absorption. Despite its proximity to the CBD the Spring Hill precinct, with mostly older stock, is struggling to remain on tenants' radar in a market dominated by upgrading. The small Toowong market has a fairly stable vacancy of 11.4% with the relocation of Allianz into the CBD being balanced by other tenant expansions in the precinct. With UQ purchasing 74 High Street for their own use this will balance CSC's relocation to the Urban Renewal precinct.

The Milton market, impacted by the relocation of Origin during 2018, is now in recovery mode with the highpoint vacancy of 23.6% in mid-2018 down to 21.5% in January 2019 and forecast to be c15-17% in July 2019.

Across the total market, after falling to 14% in mid-2019, the absence of any major new supply for the following 12 months will allow vacancy to fall to 11.2% in mid–20. The majority of improvement will come from the A grade market.

2019 supply will be confined to refurbished space

New supply was limited to the Urban Renewal precinct during 2018 with the completion of 900 Ann St, Fortitude Valley (19,971 sqm) and 25 King St, Bowen Hills (14,429sqm). Following the completion of 25 King St in November 2018 there are no new projects under construction for delivery in the Fringe.

Supply additions for 2019 will be limited to the return of refurbished stock, concentrated in the first half of the year. The major refurbishment at Valley Metro, 234 Wickham St, Fortitude Valley is expected to receive PC 28 June. The works have included the replacement of the façade and lowering of sill heights plus equipment and access upgrades.

The leasing of the majority of the building for project space has seen the property at 339 Coronation Drive, Milton return to the market earlier than expected. With a more limited refurbishment programme, now focussed on common areas and external features, the space is expected to come back on-line as at the July 2019 survey.

Increasing prime demand likely to trigger development starts in FY20

As prime tenant demand has continued to consolidate into 2019 it is expected that further major tenant requirements will trigger development starts during FY20, with the imminent Sunsuper brief intensifying activity. Table 3 shows a list of proposed developments which are awaiting pre-commitment to commence. At this stage only 470 St Pauls Terrace, Bowen Hills and 11 Breakfast Creek Rd, Newstead have pre-commitments in place, however are likely to require additional tenant commitments to proceed into construction.

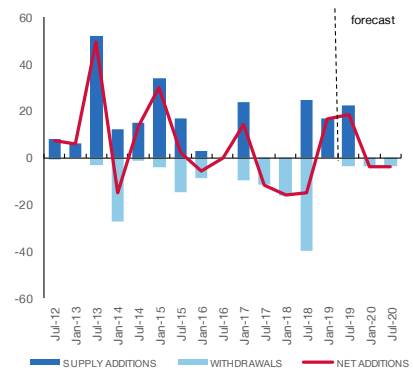
Despite some potential relaxation of lending criteria it is still expected that the majority of larger developments will require significant pre-commitment levels to commence. The scaling back in size of projects is still likely in order to progress them to construction in the short term.

Some speculative development proposed

The gap in new supply has encouraged the proposal of some smaller speculative developments. 14 Stratton Street, Newstead is a 8,924sqm proposal which has the benefit of a finished basement from surrounding residential towers, allowing for quick delivery. In Sekisui House's West End Village development there is also a proposal for 6,000sqm of commercial space within the residential and retail precinct.

The next wave of commercial supply remains tied to amenity and a vibrant neighbourhood, as this is what tenants require. This continues to concentrate development proposals to the Urban Renewal precinct and Milton Green.

FIGURE 6
Brisbane Fringe Supply
'000 sqm



Source: Knight Frank Research/PCA

"The improved prime demand and new tenant requirements are likely to trigger construction starts during FY20."

TABLE 3
Major Additions — Brisbane Fringe

Address	Precinct	NLA (m²)	% Leased	Major Tenant/s	Developer	Status	Date
K5, Showground Hill, 25 King St, Bowen Hills	Urban Renewal	14,963	44%	Aurecon	Lend Lease	Complete	Nov 18
234 Wickham St, Fortitude Valley	Urban Renewal	8,924	-	-	LaSalle Asia Opportunity Fund IV	Refurbishment	Jul 19
339 Coronation Dr, Milton	Milton	13,171	61%	CPB (Cross River Rail)	Singaporean Investor	Refurbishment	Mid-2019
Jubilee Hotel, 470 St Paul's Tce, Fortitude Valley	Urban Renewal	18,937 GFA	30%	Watpac/ Regus	JGL Properties	Approved	Late 2021
11 Breakfast Creek Rd, Newstead	Urban Renewal	27,510	16%	John Holland	Charter Hall Office Trust/ John Holland	Approved	STP
152 Wharf St, Spring Hill	Spring Hill	30,500^	^	ATO	Wharf Investment Corporation	Approved	STP
36-52 Alfred St, Fortitude Valley	Urban Renewal	32,693	-	-	LaSalle Asia Opportunity Fund IV	Approved	STP
301 Wickham St, Fortitude Valley	Urban Renewal	35,000	-	-	Cornerstone Properties	Approved	STP
31 Duncan St, Fortitude Valley	Urban Renewal	19,659	-	-	Tribune Properties	Approved	STP
CDOP 7, Milton	Milton	19,600	-	-	AMP/Sunsuper	Likely	STP
14 Stratton St, Newstead	Urban Renewal	8,924	-	-	Silverstone/Blackwatch	Application	tbc
895 Ann St, Fortitude Valley	Urban Renewal	c25,000	-	-	Consolidated Properties	Mooted	STP
West End Village	Inner South	6,000	-	-	Sekisui House	Mooted	tbc
K3, Showground Hill Bowen Hills	Urban Renewal	c25,000	-	-	Lend Lease	Mooted	STP

Source: Knight Frank Research

^reported 100% pre-commitment in place, however the timing and size of building remains unconfirmed.

RENTS & RECENT TRANSACTIONS

Rents, Incentives & Outlook

Prime Rents (g)	$584/sqm face 4.8% y-o-y $374/sqm eff 8.2% y-o-y	↗
Secondary Rents (g)	$474/sqm face 2.6% y-o-y $294/sqm eff 3.4% y-o-y	↗
Incentives	P:36.0% S:38.0%	↘

Momentum building in Fringe prime rental growth

Over the year to April 2019 prime fringe rents increased by 8.2% as confidence and tenant activity returned to the prime space. Prime Fringe rents bottomed out in April 2018, after six years of falls or stagnant growth and have shown sustained improvement since then.

The absorption of large contiguous tranches such as the Origin backfill, 900 Ann St sublease and resigning of major tenants like Technology One, CPB and Thiess have increased confidence in the market and also limited potential future construction and backfill space.

Fringe rents were slower to move than the CBD but, with 8.2% effective rental uplift from the market low-point, is now not far behind the CBD which had total effective rental growth of 11.6% from the cyclical low in 2016. Prime effective rental growth has arisen from both a recovery in incentive levels, down from 38% a year ago to the current 36%, and also solid face rental growth. Effective rental growth of 4.0% p.a on average is expected over the next two years as conditions improve, but relativity to the CBD must be maintained.

Secondary rents have grown, but remain well behind the prime market in terms of rental recovery. As the total market improves, secondary effective rents are forecast 3.5% y-o-y growth on average in the next two years.

TABLE 4

Recent Leasing Activity Brisbane Fringe

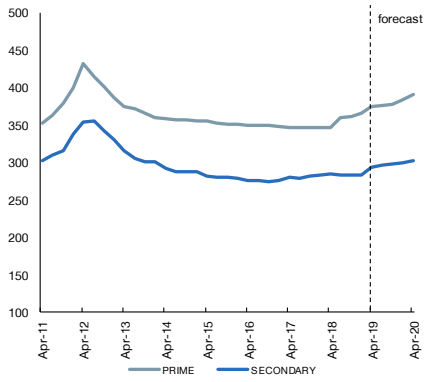
Address	NLA m²	Face Rent	Term yrs	Incentive (%)`	Tenant	Start Date
275 Grey St, South Brisbane	1,700	400 g	3	Nil	NETO^	Nov 19
339 Coronation Dr, Milton	8,071	550 g	3-5	35-40	CIMIC Cross River Rail Consortium	Jul 19
315 Brunswick St, Fortitude Valley	1,255	475 g	7	35-40	Genie Solutions	Jul 19
135 Coronation Dr, Milton	2,931	597 g	10	30-35	Sandvik	Jul 19
515 St Pauls Tce, Fortitude Valley	3,000	575 g	10	35-40	SunWater	May 19
135 Coronation Dr, Milton	7,137	588 g	8	35-40	Downer EDI Services	Q2 2019
8 Gardner Close, Milton	1,154	450 g	5	35-40	Opengear	Dec 18

Source: Knight Frank Research
`est. incentive calculated on a straight line basis g gross n net ^sub-lease

FIGURE 7

Brisbane Fringe Rents

$/m² p.a average gross effective rent



Source: Knight Frank Research

TABLE 5

Recent Sales Activity Brisbane Fringe

Address	Grade	Price $ mil	Core Market Yield %	NLA m²	$/m² NLA	WALE yrs	Vendor	Purchaser	Sale Date
315 Brunswick St, Fortitude Valley	A	117.50	5.67	14,635	4,510	4.5	Ashe Morgan Valley Heart	AM Alpha	Apr 19
74 High St, Toowong	A	19.30	VP	4,421	4,356	VP	Darveniza Group	University of QLD	Feb 19
55 Russell St, South Brisbane	B	23.65	6.98	4,081	5,795	3.6	Tasqua Holdings	Forza Russell Street Fund	Feb 19
16 Marie St, Milton	A	25.50	6.77	3,901	6,537	3.3	Unity Pacific Marie Street Trust	Trilogy Funds Management	Dec 18
The Barracks, Petrie Terrace^	A	162.32	6.24	19,509	8,320	5.3	Challenger Life	Fortius Brisbane Barracks Trust	Dec 18
100 Skyring Tce, Newstead	A	250.00	5.79	24,665	10,136	7.0	Charter Hall DOF & POF	Growthpoint Properties Australia (REIT)	Nov 18

Source: Knight Frank Research ^ mixed use retail, cinema and office complex, office NLA 11,046sqm; 43% of income

INVESTMENT ACTIVITY & YIELDS

Record Investment in FY19 with domestic funds dominant

The Brisbane Fringe, like the CBD, has recently achieved record levels of office market turnover. As shown in Figure 9, the total transactions for the FY19 to date are $1.048 billion with a number of further sales likely to complete prior to the end of the financial year. This is the highest annual figure recorded for the market and reflects the greater interest in Brisbane as an investment destination.

The largest sale was 100 Skyring Tce, Newstead, purchased for $250 million by Growthpoint Property Aust, a domestic REIT. This sale was a factor in the strength of the listed sector in terms of the recent buyer profile with 45% of transactions over the past two years. Major listed buyer activity also included Centuria Metro REIT's purchase of the Hines Global REIT portfolio, which included two Fringe assets for $256 million.

The dominance of purchasing activity by domestic funds has continued in FY19, with $805.1 million of transactions FY19 to date. Whereas offshore funds accounted for 42% of purchasing activity in both FY17 and FY18, the activity of major domestic listed and unlisted funds has restricted this to 26% in the current financial year to date, the largest being AM Alpha buying 315 Brunswick St for $117.5 million. Analysis of direct investment only may be misleading with Heitman a significant investor in the Fortius Brisbane Barracks Trust which acquired the Barracks complex for $162.32 million.

Current Yields & Outlook

Prime	5.45% - 6.60% -35bps y-o-y	↘
Secondary	7.00% - 8.10% -30bps y-o-y	↘

Assumed WALE Prime: 4-6 yrs, Secondary: 2-5 yrs

Yield compression supported by lower long-term cost of funds

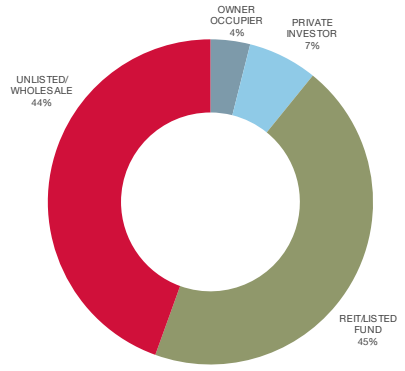
Fringe prime yields have continued to tighten, down a further 35 basis points over the past year and 260 basis points in this cycle. The prime yield range of 5.45% - 6.60% covers both modern, large scale assets at the lower range through to older, but quality assets of a lesser scale.

The risk margin between prime Fringe and CBD assets is stable from a year ago at 48 basis points, remaining well below the 10 year average of 60bps. The recent rental growth in the Fringe supports Fringe prime yields continuing to keep pace with contractions in the CBD.

The cost of funds on both long term and short term horizons has been falling in recent months with the well-anticipated 25bps cut to the cash rate announced by the RBA in early June. The Australian (and US) 10 year Government Bond yields have been decreasing since November 2018 with AUD 10 year Government bonds decreasing by 138 basis points in six months (2.76% 9/11/18 to 1.38% 14/6/19). The market currently has priced in further reductions to the 1.25% cash rate with 5 year Australian Government Bonds hovering around 1.10%. This has reversed the higher costs of funds experienced by banks during Q3 and Q4 2018 and remains supportive of yield compression.

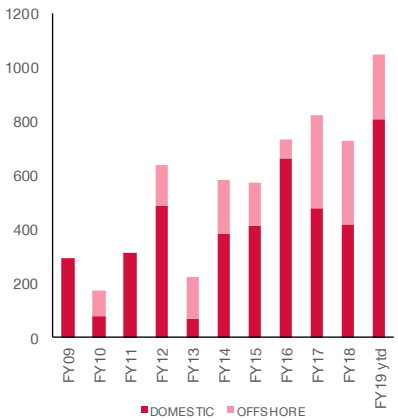
Secondary yields have also continued to tighten, albeit at a slower pace, down by 30bps over the past year. Secondary vacancy and rental growth is expected to lag prime in the Fringe market limiting the pace of yield compression during 2019. However with the weight of funds remaining high, demand flowing up the risk curve will continue to place downward pressure on yields for secondary stock.

FIGURE 8
Brisbane Fringe Purchaser Profile
FY18 + FY19 ytd



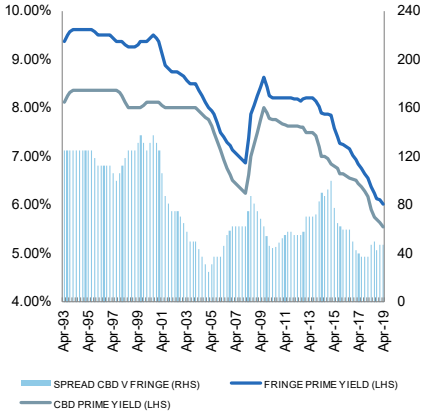
Source: Knight Frank Research

FIGURE 9
Brisbane Fringe Sales Volume
$million by source of funds



Source: Knight Frank Research

FIGURE 10
Brisbane Fringe Core Market Yield
% Prime CBD & Fringe Yield LHS & Spread RHS



Source: Knight Frank Research

Front Page Image: K5, 25 King St, Bowen Hills.

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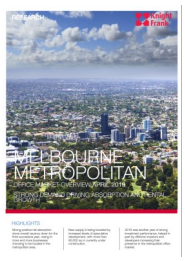

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