

BRISBANE FRINGE

OFFICE MARKET BRIEF SEPTEMBER 2014

Key Facts

H2 2014 will see 32,237m² of new construction come on line; **63%** of this is committed

Net absorption **at 18,475m²** in H2 2014 will be supported by relocations from the CBD but will **moderate in 2015**

Prime effective rents have softened with **incentives increasing to 32%**; but face rents rose

Prime Fringe yields **firmed 33bps** during the past year but remain 88bps above the CBD



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There has been strong investment demand for prime, core assets while the demand for residential development is absorbing sites and secondary properties. The leasing market is tough, but prime is to improve in the short term

Development Activity

Additions to the Fringe market during the first half of 2014 only totalled 14,733m², according to the PCA. This was dominated by the completion of 41 O’Connell Tce, Bowen Hills (7,104m²) which is 26% committed by the Legacy Way Tunnel Control Centre. Further additions came from the refurbished 27 Evelyn St, Newstead (4,800m²), occupied by the Local Government Association.

The 8,688m² building at 757 Ann St, Fortitude Valley, was completed in July and has been purchased by Investec. Close to completion is the 23,549m² Gasometer 2, Newstead which is anchored by the Bank of Queensland.

Beyond these completions there is expected to be a hiatus in construction. Lend Lease’s K1 tower (mid-2015), the Flight Centre building (2016) and Tatt’s new head office (2016/17) are the only additions proposed at this stage.

Demand for residential sites, particularly within the Fortitude Valley/Newstead and South Brisbane areas, has absorbed many of the major development sites. Analysis has indicated that this has removed approx. 180,000m² of potential future supply from development sites which previously had a commercial scheme. This residential development upswing is expected to absorb most of the “easy” sites, with the next major round of commercial development likely to require greater site amalgamation and demolition.

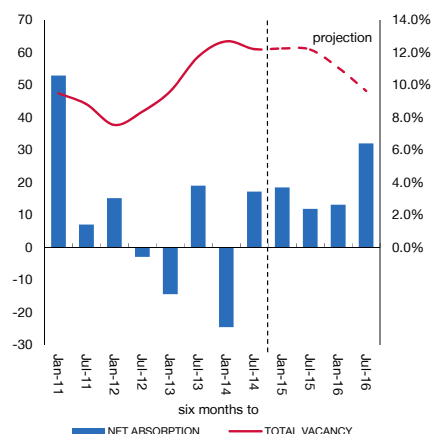
Net Absorption & Vacancy

Net Absorption within the Fringe market has been supported by companies relocating from the CBD and into newly completed accommodation, and this trend is expected to continue in the second half of 2014 with Bank of Queensland (12,595m²) and Ventyx (5,200m²) the largest examples.

Despite this boost, the expected net absorption of 18,475m² will not totally cover the level of net additional supply and the vacancy is expected to tick upwards again from the current 12.2% to 12.3%. Within a climate of little to no net additions and more modest net absorption during 2015 and fully committed new supply into 2016, the vacancy is expected to decline steadily to sit below 10% by mid-2016.

Prime vacancy is currently 9.9%, with secondary significantly higher at 14.5%. This may be impacted by the level of existing, older commercial space which may be converted to another use or demolished for residential construction. Recent examples have included 477 Boundary Rd, Spring Hill (19,500m²) which is to be converted to a hotel. Short term withdrawals are expected in TC Beirne Building, Fortitude Valley (8,458m²) and 183 Wharf St, Spring Hill (2,824m²). Further withdrawals from smaller assets are also expected.

FIGURE 1
Brisbane Fringe
'000m² net absorption LHS & Total Vacancy RHS



Source: Knight Frank/PCA

TABLE 2
Major Brisbane Fringe Projects (5,000m²+)

Project	NLA m ² & (% Leased)	Developer	Status	Date
51 Alfred St, Fortitude Valley	7,482 (-)	Private	Complete	Apr 13
Gasometer 1, Newstead	9,200 (36%)*	FKP	Complete	Jun 13
15 Green Square Cl, Fort Valley	16,300 (100%)	CBIC^	Complete	Jun 13
41 O'Connell Tce, Bowen Hills	7,104 (26%)	CBIC^	Complete	Jan 14
757 Ann St, Fortitude Valley	8,688 (80%)*	SIP Australia	Complete	Jul 14
Gasometer 2, Newstead	23,549 (57%)	Charter Hall/PSP	Construction	Sep 14
K1, Showground Hill, Bowen Hills	16,595 (50%)*	Lend Lease	Construction	2015
Southpoint, South Brisbane	22,000 (100%)	Anthony John	Construction	2016
11 Breakfast Creek Rd, Newstead	24,941 (100%)	Tatts Group#	Application	2016+

*developer commitment involved ^ City of Brisbane Investment Commission # owner occupier

Source: Knight Frank/PCA

Tenant Demand & Rents

Tenant demand for the Fringe market has been patchy with relatively good demand in evidence for modern, A grade space, particularly sub-lease space which may be available at a discount to the wider market. Sub-lease space within 100 Brookes St, Fortitude Valley has been relatively well absorbed with a number of deals done and further sub-lease space is being marketed in the HQ complex, Fortitude Valley. While absorption to the newly constructed/ under construction space has been relatively modest in 2014 these properties are now also gaining traction with further leases expected in the short term. The only confirmed lease to date is Red Chip Lawyers taking circa 1,000m² in Gasometer 2, 100 Skyring Terrace, Newstead.

Prime grade face rents have improved slightly over the over the course of 2014 with average gross face rents \$510/m² as

at July 2014. However to balance the firmer face rents, incentives have continued to grow, moving from 30% to 32% from January 2014. Therefore on an annual basis the average gross effective rent has fallen by 4.1% from July 2013 to currently average \$347/m². Some rental growth, led by the modern A grade properties, is expected to begin to emerge early 2015 as the available prime space stabilises and then begins to fall with little further space to come on line. This growth will build slowly, but average 4.1% p.a over the two years to July 2016.

Secondary rents have also continued to soften over the past 12 months, falling a further 5.6% to average \$278/m² on an effective basis (\$415/m² gross face at 33% incentive). As total vacancy is expected to remain stable until late 2014, the secondary market is unlikely to show material improvement until 2016.

The trend of CBD tenants relocating to the Fringe appears to be slowing as,

TABLE 1
Brisbane Fringe Office Market Indicators as at July 2014

Grade	Total Stock (m ²)	Vacancy Rate (%)	Annual Net Absorption (m ²)	Annual Net Additions (m ²)	Average Gross Face Rent (\$/m ²)	Average Incentive (%)	Average Core Market Yield (%)
Prime	598,790	9.9	6,470	15,994	510	32	7.50—8.25
Secondary	591,087	14.5	-13,745	-13,973	415	33	8.50—9.75
Total	1,189,877	12.2	-7,275	-2,021			

Source: Knight Frank/PCA

beyond projects currently under construction (ie Bank of Queensland, Flight Centre, Lend Lease), there are few major projects proposed which would attract further large scale relocation into the Fringe market. In addition, tenants within existing low A or B grade buildings in the Fringe are now being drawn back into the CBD on expiry due to the sharp deals being offered by CBD landlords, particularly within the B grade market.

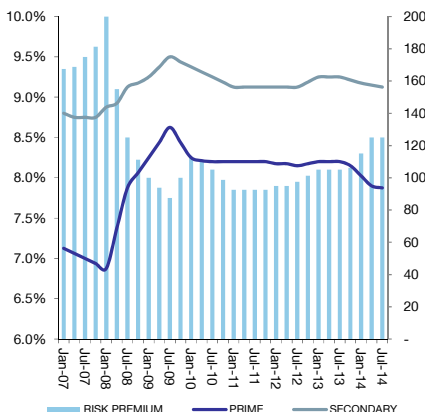
Investment Activity & Yields

The high investment demand, which is prevalent in markets across Australia, is also in force within the Fringe market, particularly for modern, A grade

FIGURE 2

Brisbane Fringe Median Yields

Yield (%) LHS & risk premium (bps) RHS



Source: Knight Frank

TABLE 3

Recent Leasing Activity Brisbane Fringe

Project	NLA m ²	Face Rent \$/m ²	Term yrs	Incentive (%) [†]	Tenant	Date
Southpoint, SB	22,000	undis	10	undis	Flight Centre *	Jun 16
K1, Kingsgate, BH	1,820	undis	undis	undis	Robert Bird *	Jun 15
Gasometer 2, 100 Skyring Tce, N	1,000	585 g	undis	35+	Red Chip Lawyers	Aug 14
100 Brookes St, FV ^	2,362	300-350 g	3#	Nil	Careers Aust	Jul 14
100 Brookes St, FV ^	3,245	300-350 g	3#	Nil	APN	Jun 14
100 Brookes St, FV ^	1,727	300-350 g	3#	Nil	WDS	Jun 14
99 Melbourne St, SB	935	525 g	5	25-30	Sibelco Group	Apr 14
601 Coronation Dr, T	1,282	500 g	6	30-35	OAMPS	Nov 13
11 Edmondstone St, SB	1,461	450 g	5	35+	QAIHC	Nov 13

[†] estimated incentive calculated on a straight line basis # approx. g gross ^ sub-lease

*pre-commitment SB South Brisbane BH Bowen Hills N Newstead FV Fortitude Valley T Toowong

Source: Knight Frank

properties. These fit the brief of many investors for core properties while providing a relatively higher yield than CBD assets. The median prime yield for the Fringe market is currently 7.88%, representing a premium of 88 basis points to the CBD (7.00%).

The Fringe prime median yield has firmed by 33 basis points over the past year under the weight of this investment demand, however secondary yields have been slower to firm, falling by 13 bps in the same time. The secondary market has not had the same investment demand as the prime market, with many of the assets sold in this category currently considered short or medium term development sites.

Over the 2013/14 financial year the Fringe market has seen \$488 million in transactions (over \$10 million) which is double the levels seen in the previous year, but lower than the \$639 million recorded in 2011/12. Transaction activity was dominated by Offshore funds (41%), AREITs (24%) and Unlisted domestic funds (23%).

The largest sale was the \$200 million fund through purchase of Southpoint Stage 1, South Brisbane, pre-committed by Flight Centre and purchased by the German-based Union Investment Real Estate. The other significant sale was the purchase of 15 Green Square Close, Fortitude Valley which was purchased by GPT for a new metropolitan fund.

TABLE 4

Recent Sales Activity Brisbane Fringe

Address	Grade	Price \$ mil	Core Market Yield %	NLA m ²	\$/m ² NLA	WALE	Vendor	Purchaser	Sale Date
757 Ann St, FV	A	65.50	8.34 [^]	9,125	7,178	7.5	SIP Australia	Investec Australia Property Fund	Aug 14
55 Little Edward St, SH	B	46.00	8.00 [^]	8,302	5,541	5.8	Bennelong Group	Generation Healthcare REIT	May 14
56 Edmondstone St, BH	A	65.98	8.52	12,427	5,309	12.0	Virgin Blue	Charter Hall Direct VA Trust	May 14
Southpoint, SB	A	200.62 [#]	7.54	28,218	7,109	10.0	Anthony John Group	Union Investment Real Estate (Unilmmo:Europa)	Apr 14
154 Melbourne St, SB	A	73.50	8.15	11,333	6,485	4.2	Pradella Group	360 Capital Office Fund	Dec 13
15 Green Square Close, FV	A	110.00	7.59	16,505	6,665	8.4	CBIC	GPT (MOF)*	Oct 13

fund through ^ passing yield * Metropolitan Office Fund SB South Brisbane BH Bowen Hills SH Spring Hill FV Fortitude Valley

Source: Knight Frank

Outlook

The Brisbane Fringe market has been similar to many markets across Australia, where investment demand has strongly outweighed the level of tenant demand.

Effective rents have deteriorated further over the past 12 months as incentives in excess of 30% have become more entrenched. On a positive note the A grade sub-lease space which has emerged has been relatively well absorbed and while the rents paid have been at a significant discount to the passing face rent for the space, they have generally been in line with the current gross effective market rental levels. The amount of sub-lease space now appears to have peaked.

With the prime vacancy currently below 10% and despite a degree of un-committed new space to be delivered over the remainder of 2014, the prime

rental market is expected to recover well in advance of the secondary market, as demand for modern accommodation in the Fringe has remained strong, particularly in South Brisbane.

Investment activity has been limited by a relative lack of assets on the market, with any new builds generally selling prior to or on completion of construction and/or with sufficient pre-commitment; and the yields for these assets are expected to continue to show downward pressure.

Secondary assets and development sites have also been in demand, however largely for current or medium term potential for redevelopment and change of use to residential/hotel, rather than long term commercial uses. The softer secondary leasing market means that value-add purchasers are requiring either development upside or a level of income support to consider an asset.

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