RESEARCH

BRISBANE FRINGE

OFFICE MARKET OVERVIEW JUNE 2015

HIGHLIGHTS

Tenant demand for new prime space has been the strongest sector of the market. With only one building under construction for completion this year, future supply will be pre-commitment led.

Effective rents fell slightly over the past year, however both prime and secondary are expected to show improvement into early 2016. Prime effective rents will return to 4-5% p.a growth from 2017.

Investment demand is strong with 80% of transactions in 2014 to core investors. The spread between prime CBD and Fringe yields is at a three year low as investors broaden their focus.

KEY FINDINGS

Total Vacancy increased to 12.8% as at January 2015**.** From this point total vacancy is expected to **trend downward.**

Prime and secondary effective rents softened by 1.0% and 2.9% respectively over the past year, but are expected to show some growth into 2016.

The prime market vacancy is decreasing with the amount of available **contiguous space falling.**

2014 was a record high level of transactions for the Fringe market; due to a lack of opportunities this is unlikely to be matched in 2015, **concentrating demand on the assets available.**

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SUPPLY & DEVELOPMENT

A relatively short supply cycle is winding down in the Fringe with pre-commitment to drive supply in the short term. The residential apartment development boom is seeing steady withdrawals of older stock.

Following the completion of 100 Skyring Tce, Newstead in late 2014 the level of supply in the Brisbane Fringe market has peaked for this cycle. Supply for the second half of 2014 was 34,084m². This was dominated by 100 Skyring Tce, Newstead (23,549m²) and 757 Ann St, Fortitude Valley (8,688m²) along with smaller office components in residential developments at Mosaic (826 Ann St, Fortitude Valley) and Kurv (31 Longland St, Newstead). When combined with the 14,733m² of additions in the first half of 2014, the 2014 supply was 48,817m². This was another strong level of supply following the 64,372m² delivered in 2013.

In the short term the level of new supply completions is expected to be lower with only one major building scheduled for completion during 2015. This is the 16,595m² K1, the first commercial stage at Lend Lease's Showground Hill development at Bowen Hills. The project is due for completion June 2015 and is currently 50% committed. With the majority of the recently completed buildings now substantially leased (See Table 2), this project has had greater interest as completion draws closer, with additional commitments rumoured.

For 2016 and 2017 confirmed additional supply comes from two fully pre-committed buildings, although some smaller additional supply is expected to emerge as the prime Fringe market recovers relatively quickly. Across the market the demand for residential development sites has diverted the majority of available sites from office proposals to residential use (removing 180,000m² of future office development).

At Southpoint, South Brisbane the Flight Centre Building is under construction with the 23,500m² office building due for completion mid-2016. Tatts Group has also received approval for a 24,941m² building at 11 Breakfast Creek Rd, Newstead which they will develop as their new head office and completion is expected prior to July 2017.

Beyond these projects, significant development may be triggered by a pre-commitment from Aurizon. The company has shortlisted a number of options in the Fringe and commitment would trigger a circa 20,000m² development for completion in 2018.

Stock Withdrawal

Stock withdrawal has become a factor in the Fringe market as the demand for residential development sites has accelerated. In the main it has been smaller office or retail buildings which have been withdrawn for development. Across significant stock, Knight Frank has tracked some 18,000m² of office space which was removed from the market during 2014 for either residential or hotel conversion or redevelopment. At this stage it is estimated that a further 20,000m² -25,000m² of office space will be removed from the market during 2015.

TABLE 1

Brisbane Fringe Office Market Indicators as at April 2015

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	619,933	12.1	20,804	44,693	530	33	7.15—8.00
Secondary	584,518	13.6	9,813	-5,801	415	34	8.25—9.50
Total	**1,204,451**	**12.8**	**29,987**	**38,892**			

Source: Knight Frank/PCA ^ as at January 2015 * series rebased April 2015

TABLE 2

Major Additions and Withdrawals— Brisbane Fringe

ADDITIONS

Address	Precinct	NLA (m^2)	% Leased	Major Tenant/s	Developer	Status	Date
41 O'Connell Tce, Bowen Hills	Urban Renewal	7,634	92%	Qld Health, QML	CBIC	Complete	Mar 14
757 Ann St, Fortitude Valley	Urban Renewal	8,688	80%	Ventyx	Van Reit Developments/ OPD (onsold to Investec)	Complete	Sep 14
100 Skyring Tce, Newstead	Urban Renewal	23,549	96%	Bank of QLD, Collection House	Charter Hall CPOF/ PSP Investment	Complete	Dec 14
K1, Showground Hill,	Urban Renewal	16,595	50%	Lend Lease	Lend Lease	Construction	Jun 15
SouthPoint, Grey St, South Brisbane	Inner South	23,500	100%	Flight Centre	Anthony John Group (onsold Union Real Estate)	Construction	Jun 16
11 Breakfast Creek Rd, Newstead	Urban Renewal	24,941	100%	Tatts Group	Tatts Group	DA Approved	Jul 17
CDOP 7, Milton	Milton	27,813	-	-	AMP/Sunsuper	Mooted	Tba
K2, Showground Hill, Bowen Hills	Urban Renewal	21,000	-	-	Lend Lease	Mooted	Tba
900 Ann St, Fortitude Valley	Urban Renewal	18,500	-	-	Consolidated Properties	Mooted	Tba
301 Wickham St, Fortitude Valley	Urban Renewal	c20,000	-	-	Cornerstone Properties	Mooted	Tba
435 St Paul's Tce, Fortitude Valley	Urban Renewal	36,682	-	-	Abcor & Grocon JV	Mooted	Tba

WITHDRAWALS

Address	Precinct	NLA (m^2)	Owner	Reason for Withdrawal	Date
477 Boundary St Spring Hill	Spring Hill	19,538	Asian Pacific Group	Conversion to residential/hotel	Dec 13
168-184 Wharf St, Spring Hill	Spring Hill	1,836	Pro-Invest Australian Opportunity Pty Ltd	Demolished for construction of hotel	Dec 14
109 Melbourne St, South Brisbane	Inner South	2,100	Aria Property Group	Demolished for construction of residential apartments	Dec 14
TC Bierne Bld, Fortitude Valley	Urban Renewal	4,458	Forwin International Investments	Conversion to hotel	Dec 14
185 Wharf St, Spring Hill	Spring Hill	2,824	Silverstone Developments*	Expected withdrawal for redevelopment (residential)	Jun 15
152 Wharf St, Spring Hill	Spring Hill	4,613	Barry Morris	Expected withdrawal for redevelopment (residential)	Dec 15
25 Donkin St, West End	Inner South	8,074	R & F Properties	Expected withdrawal for redevelopment (residential)	Dec 15
435 St Paul's Tce, Fortitude Valley	Urban Renewal	4,200	Abcor Group	Expected withdrawal for redevelopment (office or residential)	Dec 15
611 Coronation Drive, Milton	Milton	1,756	Urban Construct	Expected withdrawal for redevelopment (residential)	Dec 15
207 Wharf St, Spring Hill	Spring Hill	4,695	Private Offshore (For Sale)	Expected withdrawal for redevelopment (residential or hotel)	Jul 16
Kings Row Bld 1, Milton	Milton	4,069	Investa ICPF (For Sale)	Expected withdrawal for redevelopment (residential)	tba
50-56 Little Edward St, Spring Hill	Spring Hill	2,694	Private Investors (Under Contract)	Expected withdrawal for redevelopment (residential)	tba

Source: Knight Frank *for sale, building is empty and there is a development approval in place for a 141 unit residential development

TENANT DEMAND & RENTS

The Brisbane Fringe market reacted to new supply entering the market in late 2014, with the total vacancy increasing to 12.8% in January 2015, although it is now estimated to have dropped back to be in the order of 12.5%. The greatest impact was in the A grade market, where vacancy had increased to 12.1%, up from 9.5% mid-2014. This is slightly deceptive as demand in the prime sector has been stronger than the secondary market and this increase in vacancy has already begun to unwind.

TABLE 3

Brisbane Fringe—Vacancy Rates

Precinct	Jan 14	Jan 15
A Grade	8.8%	12.1%
Prime	**8.8%**	**12.1%**
B Grade	17.5%	15.4%
C Grade	14.5%	11.0%
D Grade	-	-
Secondary	**16.0%**	**13.6%**
Milton	14.8%	17.5%
Urban Renewal	14.2%	14.3%
Spring Hill	20.7%	17.5%
Toowong	8.4%	10.4%
Inner South	4.3%	4.1%
Total	**12.5%**	**12.8%**

Source: PCA

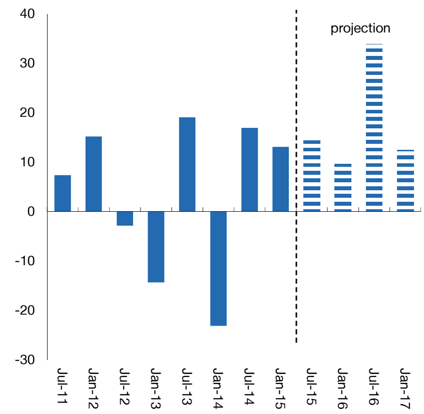
In contrast, the secondary market remains relatively weaker, despite showing some improvement to January 2015, falling to13.6%. They key impacts have been absorption by cost sensitive tenants such as education providers and also the withdrawal of stock; both of these factors have continued into 2015.

Across the precincts, the Inner South (4.1%) remains the tightest market, with all of the other precincts in double figures. Milton and Spring Hill, at 17.5% each have the highest vacancy rate although both markets are experiencing withdrawals of stock for conversion to residential development. Vacancy within the Urban Rewewal precinct has recently been static (14.3%), however take-up has been accelerating in that precinct. Toowong is the smallest market and vacancy increased slightly to 10.4%.

FIGURE 1

Brisbane Fringe Net Absorption

('000m²) per 6 month period

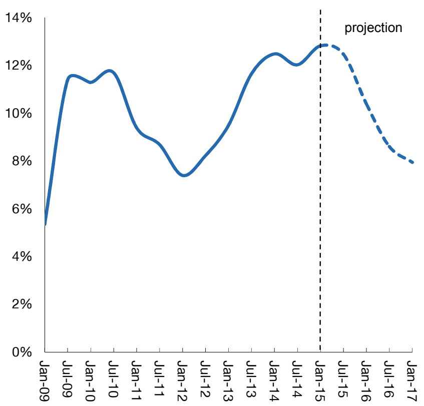


Source: Knight Frank/PCA

FIGURE 2

Brisbane Fringe Vacancy

% total vacancy



Source: Knight Frank/PCA

Net Absorption

The Brisbane Fringe market recorded positive net absorption of 29,987m² during 2014 as opposed to the –33,140m² recorded in the CBD. Fringe absorption was boosted by the relocation of tenants, largely from the CBD, into newly constructed buildings ie Bank of Queensland (12,480m²), Ventyx (5,185m²), and AACo (1,400m²).

This positive momentum is expected to be maintained across the first half of 2015 with good indications of take-up, particularly across prime sub-lease space and the leasing up of completed new builds. On completion of K1 Showground Hill at Bowen Hills, Lend Lease (6,297m²) and Robert Bird (2,000m²) will relocate from the CBD to the new Fringe building, boosting the H1 net absorption. Take-up will continue to be biased towards new completions, ie the relocation of Flight Centre (23,500m²) to purpose built premises will boost net absorption in 2016. Outside of the drawcard of modern space, the wider Fringe market is expected to face strong competition from the CBD, particularly refurbished A or B grade space. The relatively higher vacancy in the CBD (15.6%) is likely to see landlords continue to offer strong deals which may see a number of smaller to medium sized tenants drift back to the CBD market from the fringe.

Vacancy

Total vacancy appears to have reached its highpoint for the Fringe market in this cycle. As at January 2015 the total vacancy in the Fringe increased to 12.8%, under the weight of the 34,084m² in supply additions over the second half of 2014.

With only one major supply addition during 2015, which is 50% committed with tenants from outside of the Fringe market, the vacancy is expected to trend downwards over the course of 2015. It is expected to be approximately 12.5% in mid-2015 and potentially below 11% by the end of the year. Prime vacancy is expected to fall more quickly than the secondary market, with prime contiguous space options already reducing.

The vacancy is projected to continue to fall to approximately 8% by mid-2017. Beyond that time additional small to medium sized developments will emerge which will cater for the demand for prime Fringe space, placing a floor under the vacancy.

The risk to the projected steady reduction in the vacancy rate for the Fringe is that the CBD market continues to struggle and the leasing metrics on offer in that market draws greater than expected net absorption from the Fringe to the CBD.

Tenant Demand

Tenant demand has improved in 2015, however remains well below peak levels. There has been an increased level of tenant requirements coming to the market, however many of these have still elected to remain in their existing accommodation. Current larger active requirements which are considering a Fringe location are Aurizon 18,000m², Aurecon 6,000m², Brisbane Catholic Education 6,000m², NAB 4,000m², Sandvik 3,000m², Vita Group 3,000m², Hanson 3,500m² and SAP 4,000m².

As with the CBD, the education providers have been active in taking up space with Careers Australia leasing a total of 3,382m² across two sub-lease deals in late 2014.

Sub-lease space has reduced over the past six months. In mid-2014 there was a large pool, in excess of 15,000m², of prime sub-lease space, largely freed up by resource or engineering occupiers—ie Thiess, Bechtel, AECOM, Leighton Contractors and Hatch. This space has now largely been absorbed by tenants such as Careers Australia, WDS and Transmax, with most dealing on an effective basis of between $300-375/m² gross for fully fitted out accommodation.

Rental Levels

Rents have continued to moderate in the Fringe market, with face rents showing some improvement, but this was more than balanced by the increased average incentives. New accommodation has seen some good leasing activity over the past six months, with face rents in the range of $575-585/m² gross, supported by higher than average incentives to add to the allure of new accommodation. Even though the new accommodation has achieved good leasing activity, there has been no premium paid on an effective basis for this new space, achieving rents on par with other modern accommodation.

Prime gross face rents have increased by 1.9% over the past year to average $530/m² as landlords have had the opportunity to grow face rents for modern space. However over the same period, incentives have increased from an average of 31% to 33%, which has resulted in a modest fall to the effective rent of 1.0% ($355/m² gross).

Prime rents are expected to stabilise through the middle of 2015, before showing some improvement to the start of 2016. With the vacancy rate projected to show some steady falls, effective rents are expected to grow by 4.25% to April 2016 and thereafter, should the market momentum remain positive, grow in the 4 -5% p.a range in the medium term.

“Prime effective rents to grow 4.25% over the next 12 months”

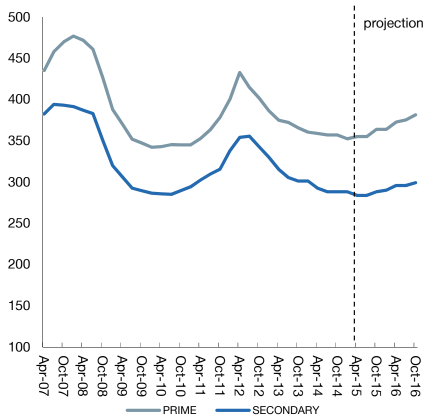
Secondary rents have remained soft over the past year with face rents remaining stable at $415/m² gross while average incentives increased to 34% (up from 32% in April 2014). This has resulted in the gross effective rent softening by 2.9% to $284/m². The effective rent is expected to remain stable for much of the remainder of 2015 before regaining some ground in early 2016 to record 2.7% annual growth to April 2016.

TABLE 4
Recent Leasing Activity Brisbane Fringe

Address	NLA m²	Face Rent $/m²	Term yrs	Incentive (%)`	Tenant	Start Date
143 Coronation Dr, Milton	1,900	525 g	7	30-35	Transmax#	Jul 15
41 O’Connell Tce, Bowen Hills	3,028	undis	7	undis	State Govt	Jul 15
199 Grey St, SB	2,230	570 g	10	35-40	Coffee Club	Apr 15
100 Skyring Tce, N	710	585 g	7	35-40	Konica Minolta	Jan 15
190 Montpelier Rd, BH	953	450 g	5	35-40	Surf Life Saving Foundation	Jan 15
100 Brookes St, FV	2,632	300 g	3	Minimal	Careers Australia#	Oct 14
100 Brookes St, FV	1,727	325 g	3	Minimal	WDS#	Oct 14
76 Skyring Tce, N	800	550 g	10	35-40	Phillip Morris	Oct 14
100 Skyring Tce, N	7,913	550 g	11	35-40	Collection House	Oct 14
22 Cordelia St, SB	1,395	550 g	8	30-35	ICON	Oct 14

Source: Knight Frank `estimated incentive calculated on a straight line basis g gross ^ pre-commitment
sub-lease N Newstead FV Fortitude Valley SB South Brisbane

FIGURE 3
Brisbane Fringe Rents
$/m² p.a average gross effective rent



Source: Knight Frank

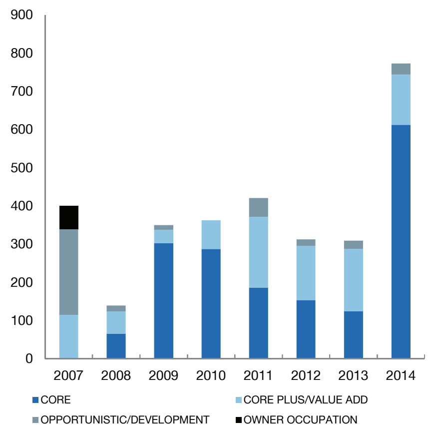
INVESTMENT ACTIVITY & YIELDS

Investment demand across the Brisbane Fringe market has continued to build in line with the wider appetite for assets. In addition, steady improvement to the asset size, build quality and depth of larger corporate tenants in the Fringe has seen this market maturation reflected in greater purchasing activity from buyers seeking core assets. The calendar year of 2014 was a stand-out in terms of total transaction levels for the Fringe with $773 million recorded, 2.5 times the level of transactions in 2013. The result was boosted by the $200.62 million pre-purchase of the Flight Centre building at South Brisbane in April 2014, but even without that sale it would have still been a record year. In response to the broadening of core investors' attention beyond the CBD, and also the available assets, Core purchasers accounted for almost 80% of all sales by value in 2014.

FIGURE 4

Brisbane Fringe Purchasing Activity

$ million transactions by purchaser type



Source: Knight Frank

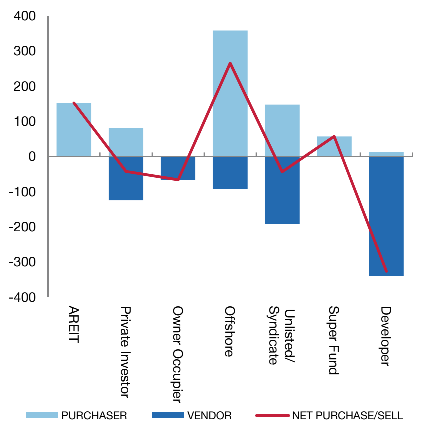
In line with the high level of core purchasing, offshore investors were the dominant purchaser over the 12 months to Q2 2015, accounting for 44% of transactions by value. This was again influenced by Union Investment Real Estates purchase of the Flight Centre building for their Unilmmo:Europa Fund; but also boosted by Mapletree's $92.75 million purchase of 144 Montague Rd, West End and 757 Ann Street purchased by the Investec Australia Property Fund for $65.5 million.

AREITs were also strong purchasers, accounting for 19% of transactions, followed closely by the Unlisted Funds/ Syndicates at 18%. However the unlisted funds and syndicates were also significant sellers of stock over the 12 month period (ie 555 Coronation Drive, $33.40 million and 74 High St, Toowong $21.50 million) which led to them being net sellers over the year.

FIGURE 5

Brisbane Fringe Purchaser/Vendor

$ million sales ($10 million+) 12mths to Q2 2015



Source: Knight Frank

Private investors and owner occupiers were also modest net sellers of Fringe office accommodation. Developers, with $339.6 million in sales, were by far the strongest net sellers and these were largely new or relatively new office assets with good tenants and long WALES. This reflects where buyer demand is concentrated. With the leasing market still relatively difficult at the current time, there is still a premium being paid for a longer WALE to offset against leasing risk.

TABLE 5

Recent Sales Activity Brisbane Fringe

Address	Grade	Price $ mil	Core Market Yield %	NLA m²	$/m² NLA	WALE	Vendor	Purchaser	Sale Date
16 Marie St, Milton	A	20.42	8.63	3,937	5,188	4.9	Private Investors	Marie Street Trust (Unity Pacific)	Mar 15
41 Buchanan St, West End	A	20.00	7.63^	3,383	5,912	6.5	Private Investor	Private Investor	Feb 15
555 Coronation Drive, Milton	B	33.40	8.63	5,591	5,974	4.0	Sentinel Property Group	Centuria Metropolitan Fund	Dec 14
144 Montague Rd, West End	A	92.75	8.56	14,742	6,292	6.9	Hines Global REIT	Mapletree	Nov 14
153 Campbell St, Bowen Hills	B	62.00	8.81	15,696	3,950	2.2	Centuria Office Fund No. 2	Sentinel Property Group	Nov 14
74 High St, Toowong	A	21.50	8.83	4,431	4,852	3.9	IOOF	Private Investor	Oct 14
Petrie Barracks, Petrie Terrace*	A	58.00	8.50	11,046	5,251	3.8	Private Investor (developers)	Challenger Life	Oct 14

^ passing yield *sold with the adjoining retail and cinema complex for $143 million, details are as allocated for the office component and not confirmed

Source: Knight Frank

As investment demand has continued to build, activity has been limited by the relative lack of assets on the market. In response, yields have shown significant tightening over the past six months with the current average prime yield range of 7.15% - 8.00% representing a tightening of 30 basis points over the past six months and a total of 105 basis points over the course of this tightening cycle.

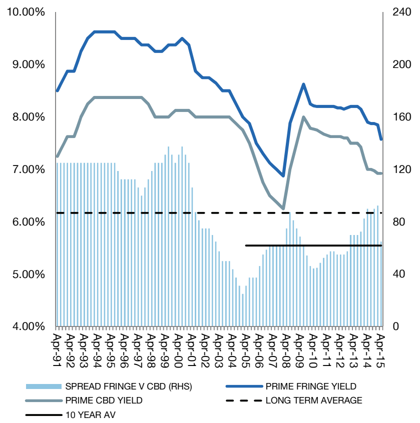
As shown in Figure 6, over the past two years, the prime Fringe yields were slower to show significant contraction than was the CBD. As at April 2015 the spread between CBD and Fringe prime yields was 65 basis points, this is in line with the 10 year average of 62 basis points, but below the longer term average, from 1991, of 87 basis points. This further reinforces the re-rating of the Fringe market over the past five years.

At the time of writing there were relatively few major assets on the market in the Fringe. K1 Showground Hill at Bowen Hills is expected to be sold at the completion of its marketing campaign. Offered to the market with a rental guarantee from Lend Lease over approximately half of the floors, the resulting WALE of approx. 8 years is expected to test the lower prime yield range.

Secondary Fringe yields have shown a firming trend over the past six months, with demand for residential development sites also strong in the market for smaller secondary buildings. The current secondary yield range is 8.25% - 9.50%, firming by 25 basis points in the past six months. Secondary assets with short WALEs and the potential for high rise residential development have become the focus of developers with a number of sales occurring in this sphere.

Yields are expected to remain on a firming trend as investment demand remains high. Even though there has been a recent increase in the long term bond rates of c60bps, the prime yield spread to bonds remains well above average levels and the market can absorb some sustained narrowing of this margin.

FIGURE 6
Brisbane Core Market Yields
% Yield LHS Fringe v CBD & Basis Points RHS



Source: Knight Frank

"The spread between CBD and Fringe prime yields is the lowest in three years"

Outlook

- Supply is expected to be lower in the medium term with only one major building slated for completion this year. With the residential development boom absorbing development sites, medium term supply is likely to be limited to pre-committed construction.
- Older style and secondary stock is being recycled to be either converted or demolished for redevelopment—largely as residential or hotel projects. In 2015 approximately 20,000—25,000m² of stock is expected to be withdrawn.
- With relatively little new supply in the pipeline to impact on vacancy, the total vacancy level is expected to reduce over the next two years. There are already indications that prime vacancies are tightening quicker than expected, particularly on contiguous space.
- Effective rents are expected to remain at similar levels over the majority of 2015, with little further increases to incentives expected, particularly in the prime market. Effective rental growth is expected to begin to be in evidence from late 2015.
- Yields have firmed across both prime and secondary properties and this trend is likely to continue in the medium term. The recent increase in the long term bond rates, up 60-70 basis points from record lows in April, may decrease the speed, but not stop, this yield tightening cycle.
- 2014 was a record year in terms of total transaction turnover for the Fringe market. With prime stock tightly held, the lack of new development and sale options indicates that the transaction levels for 2015 may not be as high, however there will be greater competition for assets marketed.

Definitions:
Core Market Yield: The percentage return/yield analysed when the assessed fully leased net market income is divided by the adopted value/price which has been adjusted to account for property specific issues (i.e. rental reversions, rental downtime for imminent expiries, capital expenditure, current vacancies, incentives, etc).
WALE: Weighted Average Lease Expiry
Precincts:
Milton—Includes the suburbs of Milton and Petrie Terrace
Urban Renewal—Includes the suburbs of Fortitude Valley, Newstead and Bowen Hills
Spring Hill—Spring Hill
Toowong—Toowong
Inner South—Includes the suburbs of South Brisbane, West End, Kangaroo Point, East Brisbane and Woolloongabba

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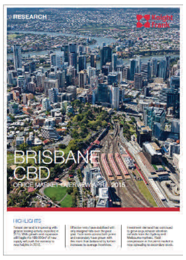
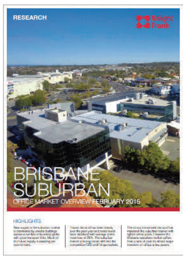


Brisbane CBD Office Market Overview April 2015



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