RESEARCH

MAY 2013

BRISBANE FRINGE

Office Market Brief

HIGHLIGHTS

- The Brisbane Fringe has seen several strong pre-commitments to office space trigger new construction, however existing accommodation is facing greater challenges with the vacancy rate of 9.6% as at January 2013 expected to climb to 12.2% mid-year. New supply delivery for 2013 is concentrated in the first half of the year with 49,156m², of which 72% is committed.
- Despite a return to positive net absorption of 13,440m² in H1 2013, it will not outweigh the supply and thus further increase the vacancy rate in the short term. The growing vacancy has already impacted on market rental levels for existing accommodation with effective rents falling by 13.3% for the prime market, and 11.0% for secondary over the past year. This has largely occurred due to the strong return of incentives in the market. Conditions are expected to remain relatively soft for the coming 12-18 months, with improvement in 2015.
- The investment market has remained strong, particularly for new assets which offer good tenant covenants and long WALEs. The Brisbane Fringe market has continued to attract investment by both local and global major institutional investors, some of which are taking on development risk. Outside of this upper level market activity, the general investment market has been relatively slow, dominated by opportunistic private investors.

Table 1
Brisbane Fringe Office Market Indicators as at April 2013

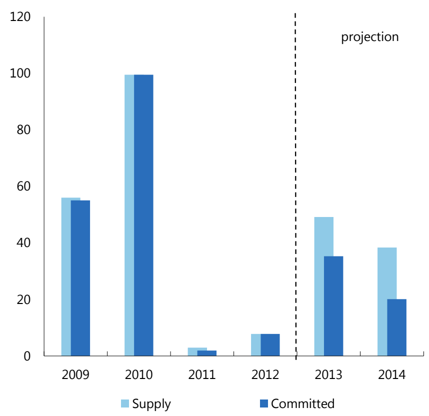
Grade	Total Stock (m^2) ^	Vacancy Rate (%)^	Annual Net Absorption (m^2)^	Annual Net Additions (m^2)^	Average Gross Face Rent (\$/m^2)	Average Incentive (%)	Average Core Market Yield (%)
Prime	531,962	6.2	-11,706	5,167	502	27.5	7.90 – 8.50
Secondary	610,754	12.6	-5,505	1,904	420	27.5	8.75 – 9.75
Total	**1,142,716**	**9.6**	**-17,211**	**7,071**			

Source: Knight Frank/PCA ^as at January 2013

Supply & Development

The first half of 2013 will see new stock completions in the order of 49,156m², much of which is already complete, and is 72% committed. Projects such as 825 Ann Street, Fortitude Valley (17,788m²) and 15 Green Square Close, Fortitude Valley (16,302m²) are fully leased, however other projects such as Gasometer 1, Newstead (7,800m² - 15% committed) and 51 Alfred Street, Fortitude Valley (7,266m²) face greater challenges. Beyond these projects which are either completed, or are expected be completed prior to 30 June, there are three further projects under construction. These are Gasometer 2, Newstead (23,420m², 59% committed to Bank of Qld); 757 Ann Street, Fortitude Valley (7,815m², 81% committed to Ventyx) and 41 O'Connell Tce, Bowen Hills (7,104m², 26% committed to Legacy Way Tunnel Control).

Figure 1
Brisbane Fringe Supply
('000m²) Supply (new & refurb) & commitment



Source: Knight Frank/PCA

There remains a long list of development projects which have approvals in place, however are awaiting the necessary tenant commitment to begin construction. Knight Frank is currently tracking some 155,000m² of potential supply which is poised for construction starts, but remain subject to pre-commitment.

With a number of larger tenants currently in the market and considering either CBD or Fringe accommodation (eg Flight Centre for 16,000m²) it is expected that new construction will continue to flow through the market. At this stage supply is expected to be 38,400m² for 2014, lower during 2015 and then accelerate into 2016 off the back of further tenant pre-commitments.

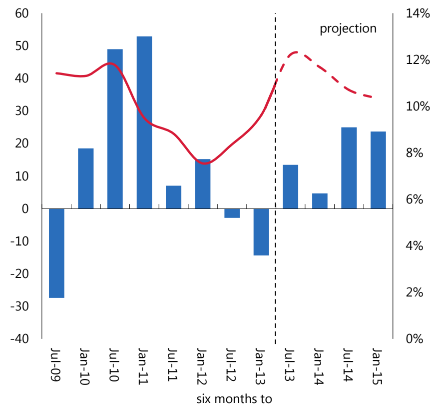
Net Absorption & Vacancy

Following two periods of negative net absorption across the Brisbane Fringe, totalling -17,211m² in 2012, the tide is expected to turn, with the results for the first half of 2013 expected to be positive. This is entirely due to the relocation of tenants from the Brisbane CBD market into the Fringe, representing a net inflow for the market. This boost from tenants such as Urban Utilities, Laing O'Rourke and Macquarie Bank will assist to bring the net absorption out of negative territory with 13,440m² of positive take-up projected in H1 2013.

With organic growth within the fringe currently muted by the lack of confidence, the space taken by tenants relocating into the Fringe market will provide the bulk of the positive net absorption over the next two years.

Despite a return to positive net absorption, the vacancy rate is still set to increase under the weight of the additional 49,156m² of stock being brought to the market. The vacancy is expected to reach 12.2% as at mid-2013, and then begin to fall as supply in H2 2013 is minimal. A return to growth conditions during 2014, and supply with large pre-commitments from CBD based tenants, should see the vacancy fall back below double digits by mid-2015.

Figure 2
Brisbane Fringe Demand & Vacancy
('000m²) Net Absorption (LHS) & Vacancy Rate (RHS)

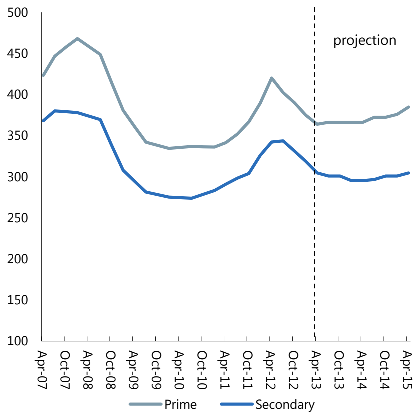


Source: Knight Frank/PCA

Tenant Demand & Rents

The increasing vacancy and slower tenant demand has had a negative impact on market rents over the past nine months. In addition there is a significant amount of fitted-out, sub-lease space, often priced at very competitive rental levels, diverting demand from direct space. The average prime face rent is stable, at \$502/m² gross as at April 2013, however incentives have increased to average 27.5% across the market, up from 16.0% a year earlier, resulting in a fall in gross effective rentals of 13.3%. These prime market rents are dwarfed by the rentals being achieved for new generation stock ($575 – 625/m² gross face), with the gap between existing stock and new space continuing to widen.

Figure 3
Brisbane Fringe Rents
$/m² gross effective Prime & Secondary



Source: Knight Frank

Secondary space is also struggling to attract activity with average face rents falling 1.2% over the past year to $420/m² gross and incentives increasing from 19.5% to 27.5% over the same period, a fall of 11.0% in effective rents. Prospects for rental recovery are aligned with generally better conditions in the market emerging in 2015.

Investment Activity & Yields

Investment activity within the Fringe market has recently been boosted by the settlement of Hines Global REIT's purchase of 825 Ann Street, Fortitude Valley for $124.7 million and the announcement by Charter Hall/PSP Investments that they will acquire the site of the Bank of Queensland project in Newstead from FKP. The project has an end value in the region of $160 million. The Brisbane Fringe market, unlike most other non-CBD markets across Australia, continues to attract global and local institutional investors. This is due to both the level of recent construction, providing new building fabric and the calibre of the tenants being drawn to this space.

Yields have a firming bias for prime assets, although demand remains strongest for new assets which provide a long WALE. Average prime yields currently fall within the range of 7.90% - 8.50% with the range narrowing, due to some firming at the upper end being balanced by a barrier slightly below 8%, which has remained stable. However secondary yields have been impacted by the continued negative sentiment surrounding tenant demand, and range 8.75% - 9.75%, an increase of 13bps over the past year.

Table 2
Recent Leasing Activity Brisbane Fringe

Address	Area (sq m)	Face Rental ($/m²)	Term (yrs)	Incentive (%)`	Tenant	Start Date
757 Ann St, FV	6,305	560 n	10	20-25	Ventyx*	Jan 14
Gasometer 1, Newstead	1,200	590 g	10	20-25	AAco*	Mar 13
15 Green Square Close, FV	2,184	580 g	10	20-25	Oil Search*	Mar 13
121 Wharf St, SH	895	525 g	5	30+	Bridge Point	Feb 13
143 Coronation Dr, M	1,301	500 g	7	20-25	Thiess	Feb 13
60 Leichhardt St, SH	983	395 g	7	25-30	Ace Insurance	Jan 13
55 Little Edward St, SH	2,543	435 g	10	20-25	Qld Fertility Clinic	Dec 12

Source: Knight Frank g gross n net FV Fortitude Valley SH Spring Hill SB South Brisbane M Milton
`estimated incentive calculated on a straight line basis *Pre-commitment/new space

Outlook

There are widely divergent fortunes across the Fringe market at this time, with demand and investor interest in new projects and pre-commitment space at high levels. However much of the existing stock is battling the headwinds of increasing vacancy and sluggish decision-making from tenants, with vacancy and rental levels expected to suffer in the short term.

This will only continue to widen the gap between newly constructed accommodation and existing space – both in terms of rental/tenant profiles and also investment demand. Effective rents are expected to drift over the coming year, with prime rents forecast to be stable but secondary rents are forecast to fall a further 3.1% as face rents erode in the face of extreme competition. A general market recovery is expected to emerge from mid-2015 as the vacancy falls below 10%.

Table 3
Recent Sales Activity Brisbane Fringe

Address	Grade	Price ($ mil)	Core Market Yield (%)	NLA (m²)	$/m² NLA	WALE	Vendor	Purchaser	Sale Date
825 Ann St, FV	A	124.7	7.94	18,742	6,654	9.5	Laing O'Rourke	Hines Global REIT	Apr 13
24 Markwell Tce, Bowen Hills	-	6.00	Site	7,625#	787#	Site	Brisbane City Council	Sonic Health	Mar 13
15 Astor Tce, SH	B	9.50	n/a~	3,870	2,455	n/a	Opus Capital	Private Investors	Feb 13
252 St Pauls Tce, Fortitude Valley	B	17.37	10.28^	3,627	4,789	6.0	Private Investor	Offshore Investor	Nov 12

Source: Knight Frank ^ passing yield # Site Area and $/m² of site ~Sold with 37% vacancy FV Fortitude Valley SH Spring Hill

RESEARCH

Americas
USA
Bermuda
Brazil
Canada
Caribbean
Chile

Australasia
Australia
New Zealand

Europe
UK
Belgium
Czech Republic
France
Germany
Hungary
Ireland
Italy
Monaco
Poland
Portugal
Romania
Russia
Spain
The Netherlands
Ukraine

Africa
Botswana
Kenya
Malawi
Nigeria
South Africa
Tanzania
Uganda
Zambia
Zimbabwe

Asia
Cambodia
China
Hong Kong
India
Indonesia
Macau
Malaysia
Singapore
South Korea
Thailand
Vietnam

The Gulf
Bahrain
Abu Dhabi, UAE

Knight Frank Newmark Global

Knight Frank Research

Jennelle Wilson
Director – Research QLD
+61 7 3246 8830
Jennelle.Wilson@au.knightfrank.com

Matt Whitby
National Director
Head of Research & Consultancy
+61 2 9036 6616
Matt.Whitby@au.knightfrank.com

Knight Frank Valuations

Peter Zischke
Director
+61 7 3246 8811
Peter.Zischke@qld.knightfrankval.com.au

Commercial Agency Contacts

David Fowler
Director – Capital Markets
+61 7 3246 8823
David.Fowler@au.knightfrank.com

Grant Whittaker
Managing Director – Queensland
+61 7 3246 8888
Grant.Whittaker@au.knightfrank.com

Andrew Carlton
Director – Office Leasing
+61 7 3246 8860
Andrew.Carlton@au.knightfrank.com

Jason Hines
Director – Office Leasing
+61 7 3246 8809
Jason.Hines@au.knightfrank.com

Shane Van Beest
Associate Director – Office Leasing
+61 7 3246 8803
Shane.VanBeest@au.knightfrank.com

Nick Ritchie
Operator – Office Leasing
+61 7 3246 8824
Nick.Ritchie@au.knightfrank.com

Knight Frank Research provide strategic advice, consultancy services and forecasting to a wide range of clients worldwide including developers, investors, financial and corporate institutions. All recognise the need for the provision of expert independent advice customised to their specific needs.

Knight Frank Research reports are also available at KnightFrank.com.au