RESEARCH

NOVEMBER 2011

BRISBANE NEAR CITY

Office Market Overview

Knight Frank

HIGHLIGHTS

- The vacancy rate across the Near City is contracting, largely due to sustained improvements in the prime market, where vacancy is now only 4.3%. A lack of contiguous prime supply is expected to continue to tighten the market while the secondary market lags, with vacancy for that sub-market at 12.7% and expected to remain in double digits in the medium term.
- Given the reduction in available prime space, developers are once again considering speculative development. Projects under construction are heavily pre-committed (70% for new stock in 2011 and 84% for 2012 additions) but some speculative activity is expected to return to the market in the near future.
- The investment market has been most active for properties under $25 million with smaller investment houses and private developers positioning to capture the upside in rentals, forecast to return in 2012 – 2014. Yields have remained relatively stable, however value uplift has come from improving rental and leasing-up assumptions.

BRISBANE NEAR CITY OVERVIEW

Table 1
Brisbane Near City Office Market Indicators as at October 2011

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	527,325	4.3	60,328	28,600	470	23	7.60 – 8.70
Secondary	608,302	12.7	-385	1,484	400	24	8.75 – 9.50
Total	**1,135,627**	**8.8**	**59,943**	**30,084**			

Source: Knight Frank/PCA ^ PCA OMR July 2011

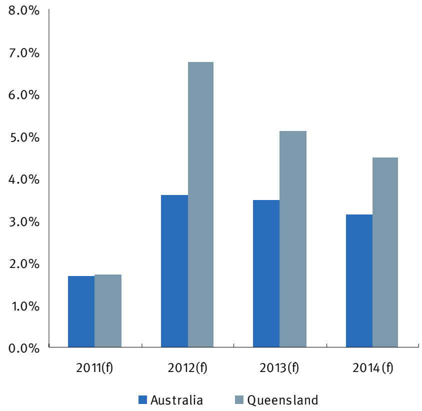
Economic Context

The economic context has been clouded by the uncertainty engendered by a series of sentiment-impacting events. These have been largely within Europe, but China's economic health and the speed of economic recovery across the USA are also under focus.

Despite this, the recent months have seen economic indicators which have generally been on the upside of expectations, even though the consumer and business confidence levels remain lower. Basic indicators such as CPI (3.5% Sept Qtr ABS), Retail Sales (2.4% p.a trend gth as at Sept 2011 ABS), unemployment (relatively stable at 5.2% Sept 2011) and recent sustained improvements in the balance of trade figures (imports +8% exports +3% Aug 2011 ABS) all point to economic conditions being solid.

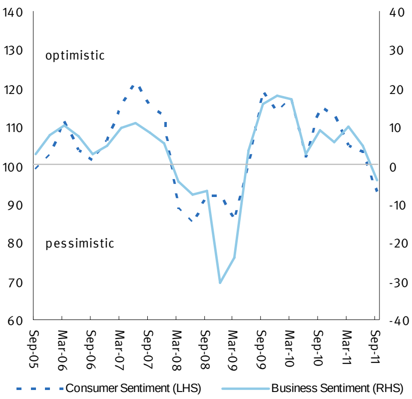
Economic forecasts released by Deloitte Access Economics in Q3 2011 indicate that a strong rebound is still expected for the Australian and Qld economies in 2012. Figure 1 shows that from the positive, but relatively modest levels of 1.7% forecast for both Qld and Australia for 2011, economic growth is forecast to accelerate rapidly to 3.6% for Australia and a significant 6.7% for Queensland. It is therefore expected that Qld will return to outperforming Australia in terms of economic growth, boosted by a number of coal mines returning to production from 2010/11 floods and other natural resource projects reaching maturity and production.

Figure 1
Australia GDP & Qld GSP Forecast
% p.a Forecast Annual Growth



Source: Deloitte Access Economics Q3 2011

Figure 2
Australian Confidence Indicators
Index Consumer Sentiment & Business Sentiment



Source: Westpac/MI & NAB

Following the 25bps cut in November; the short term money market is still pricing in a decrease in the target cash rate of up to 50bps to early 2012 and up to 100bps by Q3 2012; based on the interbank cash rate future implied yields. While this quantum of interest rate reduction is not expected to translate through to the investment finance market in full, the general expectation remains for relatively steady or softening interest rates.

ECONOMIC INDICATORS HAVE BEEN SOLID BUT CONFIDENCE REMAINS FRAGILE

Figure 2 shows the quarterly results for both the Westpac/MI consumer sentiment and the NAB business sentiment surveys. Both indicators have recently taken a tumble back into the "pessimistic" zone. While the monthly figures for consumer sentiment for October showed some improvement, they remained slightly negative at 97.2. The Near City market has matured greatly over recent years, becoming more of a desirable location for major companies and institutional investors, however confidence remains the greatest hurdle for the market.

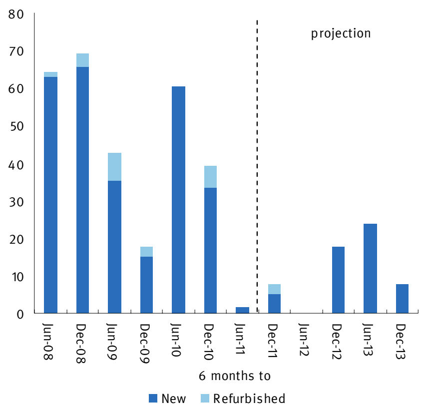
SUPPLY & DEVELOPMENT ACTIVITY

Development Cycle

There is very little new supply to come on line within the market until late 2012. This is largely made up of two projects, the ABC Headquarters and 825 Ann Street. The ABC Headquarters is under construction (the total building is approximately 15,000m^2 of which c4,000m^2 is expected to be pure office space) with an expected completion of late this year. The other major building at 825 Ann Street, known as M&A, is on track for an expected completion in late 2012. The project is 84% pre-committed with developer Laing O'Rourke taking 8,035m^2 and Ergon Energy committing to a 10 year deal over 6,568m^2.

The next phase of major completions has now emerged and two buildings are in the early stages of development. FKP has launched the next stage of development at The Gasworks with site works underway for a building containing 7,420m^2 of office space. The City of Brisbane Investment Corporation has also commenced site works on Stage 3 of Green Square, a building of 16,300m^2. Approximately half of the building was pre-committed to Urban Utilities. Both of these projects are currently expected to be completed during the course of 2013.

Figure 3
Brisbane Near City – Supply
'000m^2 new and refurbished stock



Source: PCA/Knight Frank

Table 2
Brisbane Near City Supply – ›2,500m^2

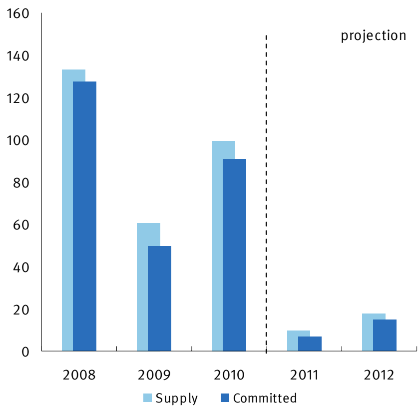
Project	NLA (sq m)	% Leased	Developer	Status	Date
15 James St, Fortitude Valley	2,619	100	Private	Refurbishment	Dec 11
ABC Headquarters, Inner South	4,000~	100	ABC	Construction	Dec 11
825 Ann St, Fortitude Valley	17,467	84	Laing O'Rourke	Construction	Dec 12
The Gasworks, GWO1, Newstead	7,420	25*	FKP	Site Works	Early 2013
15 Green Square Cl, Fort. Valley	16,300	50	CBIC^	Site works	Jun 13
757 Ann St, Fortitude Valley	7,801	-	Vanriet	Application	Dec 13
Southpoint, Inner South	30,000	-	Anthony John Gp	Approved	s.t.p
51 Alfred St, Fortitude Valley	6,617	-	Private	Application	s.t.p
RNA Stage 1, Bowen Hills	10,250+	33*	Lend Lease	Masterplan Approved	s.t.p
11 Breakfast Creek Rd, Newstead	17,744	-	Watpac	Approved	s.t.p
The Gasworks, GWO2, Newstead	12,385	-	FKP	Approved	s.t.p
The Gasworks, GWO3, Newstead	16,690	-	FKP	Approved	s.t.p

Source: Knight Frank *developer commitment ^ City of Brisbane Investment Commission
s.t.p – subject to pre-commitment ~ pure office component

SPEC ACTIVITY TO INCREASE

Further development sites exist with either longstanding or recently revived development proposals in place. Knight Frank is currently tracking some 50,000m^2 of developments targeting 2013 or 2014 completion. The proposed Southpoint Development at South Brisbane is the only remaining fringe development site shortlisted for the Suncorp requirement and thus remains a prospect for completion in 2014, subject to the tenant commitment. The Queensland Health requirement of 30,000m^2 in Bowen Hills has also seen a number of developers put forward proposals. These include the RNA Showgrounds, 58-66 Abbostford Rd and the Queensland Rail site opposite Bowen Hills Railway Station. Major development on these sites is not likely in the short term unless the project secures Qld Health.

Figure 4
Brisbane Near City – commitment levels
'000 commitment to supply



Source: Knight Frank

Despite improved tenant conditions there is still little speculative development underway, although a number of developers are advancing plans to commence construction on a speculative basis. At this stage supply for 2011 (70% committed) and 2012 (84% committed) is dominated by developments undertaken in response to pre-commitments.

TENANT DEMAND & RENTS

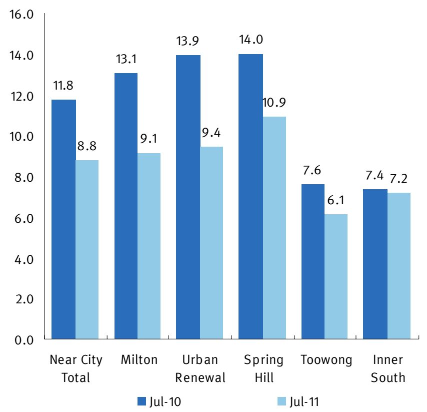
Vacancy levels have continued to fall across the Near City market during 2011. The speed of the improvement has been most obvious in the prime market. The vacancy rate of 4.3% as at the July 2011 survey was a significant improvement from the 6.1% recorded in January 2011 and a major improvement from the 10.9% recorded mid-2010. The prime market could currently therefore be considered as “tight” (benchmark for equilibrium is generally considered to be 4.0 – 6.0%). The secondary market however has increased slightly to 12.7% and has been above 12% since early 2010.

Table 3
Vacancy Rates Brisbane Near City

Grade	Vacancy (%) Jul 10	Jul 11
A Grade	10.9	4.3
B Grade	15.6	14.9
C Grade	6.8	9.2
D Grade	0.5	0.5
Prime	**10.9**	**4.3**
Secondary	12.5	12.7
Total	11.8	8.8

Source: Property Council of Australia

Figure 5
Brisbane Near City Vacancy
% total vacancy by precinct July 2010 & 2011



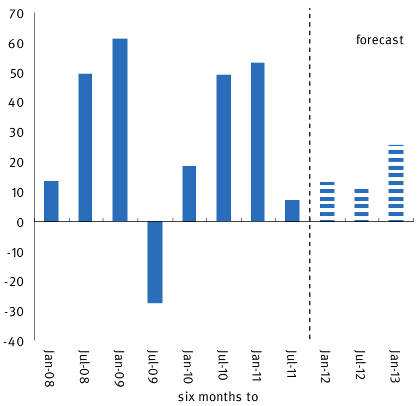
Source: PCA

Figure 5 shows that significant improvements have been made across all of the precincts which were showing elevated vacancy levels in mid-2010. Milton, the Urban Renewal precinct and Spring Hill recorded vacancy levels of 13.1% - 14.0% and these have now recovered to a more reasonable 9.1% - 10.9%

Net Absorption

After the recent record levels of net absorption, the lack of new stock associated with large tenant relocations has reduced the level of net absorption in the market during 2011. After net absorption of 101,816m^2 in the CY 2010, supported by major relocations into the Near City market (ie Energex and Ausenco) net absorption over the first six months of 2011 was limited to growth from smaller tenants. This resulted in net absorption of 7,053m^2, as the market entered a quieter period following the strong growth of 2008 – 2010.

Figure 6
Brisbane Near City Net Absorption
‘000 per six month period



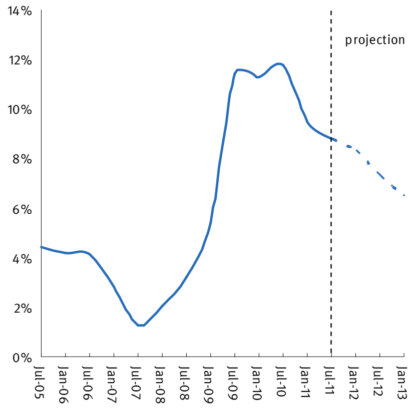
Source: Knight Frank/PCA

Demand has remained concentrated within the prime sector of the market with upgrading accommodation the major driver for tenant relocations. Prime net absorption over the past six months was 9,647m^2, in comparison with secondary net absorption of -2,549m^2. The C grade market performed worst with -3,737m^2 while B grade space recorded slightly positive net absorption of 1,143m^2.

In the short term, net absorption is expected to remain relatively muted until the next round of supply additions engenders major tenant relocations. Thus forecasts of net absorption range between 11,000 – 13,000m^2 per six months until late 2012/early 2013 and the expected completion of a number of new developments.

Anticipated Vacancy Levels

Figure 7
Brisbane Near City Vacancy
% total vacancy



Source: Knight Frank/PCA

The vacancy rate is expected to continue to gradually decline as moderate but positive demand absorbs the vacant space within a climate of little or no supply. The vacancy rate was recorded at 8.8% as at the July 2011 survey and is expected to fall marginally to 8.3% by the end of 2011.

Gradual declines are expected through until early 2013, down to approximately 6.5%, when the larger supply additions are expected to arrest this downward movement. The level of pent up demand for new stock is expected to translate to stabilisation of the vacancy rate rather than increases as the next supply cycle hits in 2013/2014.

Tenant Demand

Tenant activity in the Near City has again been dominated by engineering or mining/energy tenants over 2011. Bechtel has continued to expand, taking a further 6,500m² of expansion space during 2011. Bechtel has taken a total of 19,000m² in expansion space over the past 12 months, the majority of which is related to project space, dwarfing their main office holding of just over 10,000m².

Ergon energy is also expanding, taking a major pre-commitment in 825 Ann Street and also taking expansion space of 1,326m² to cover their short term needs. Origin Energy has also grown in size, taking an additional 5,666m² in South Brisbane just 18 months after taking 12,800m² of space in the newly constructed Coronation Drive Office Park Building 4, Milton.

Outside of these major users, recent leasing activity has been dominated by smaller mid tier tenants coming from a variety of industry types. The next round of tenant led construction is also being clarified as Urban Utilities has committed to 8,000m² in the Stage 3 Green Square project. There are also a number of larger requirements active within the market, with Suncorp yet to finalise their decision on a CBD versus Near City location. Bank of Qld's requirement for 14,000m² would consider a Near City location, as would

Table 5
Major Near City Requirements
As at November 2011

Tenant	Area * (m²)	Timing
Nth Qld Bulk Ports	1,500	2011
IBM	950	2012
Oil Search	1,200	2012
APA Group	1,700	2012
Optus*	6,000	2013
Qld Govt*	5,000	2013
Suncorp*	30,000	2014
Bank of Qld*	14,000	2014
Qld Health`	30,000	tbc

* consider CBD or Near City `Bowen Hills only
Source: Knight Frank

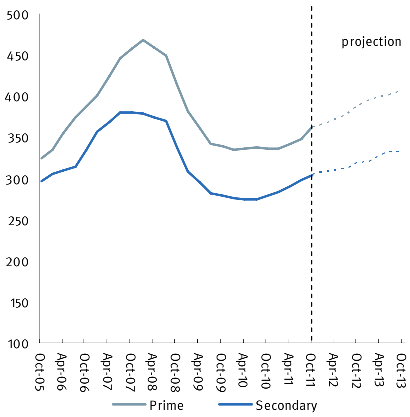
Optus which is seeking 6,000m². The Queensland Government also has a requirement for 5,000m² either in the CBD or Near City and Queensland Health is seeking expressions of interest on 30,000m² within Bowen Hills.

Rental Levels

Rental levels within the Near City market have increased over the past year as the market has begun to recover. After reaching low points in early 2010 when the vacancy rates were in excess of 11%, the rental conditions have improved as vacancy levels have contracted. Prime effective rental levels have increased 8.2% from the cyclical low to currently sit at $362/m² ($470/m² gross face with 23% incentives). Despite this growth, the rental rates, on average, remain 22.6% below the market peak in early 2008.

Secondary rental levels have also recovered, growing by 9.2% over the past 12 months from the low-point of the market. This has signalled an end to the extreme discounting which was undertaken by landlords as the secondary vacancy level breached 12.5%. Although the secondary vacancy levels are not expected to reduce below double digits in the medium term, the overall improvement in market conditions has allowed the rental rates to return to more realistic levels.

Figure 8
Brisbane Near City Rents
Prime & Secondary $/m² gross effective



Source: Knight Frank

Table 4
Recent Leasing Activity Brisbane Near City

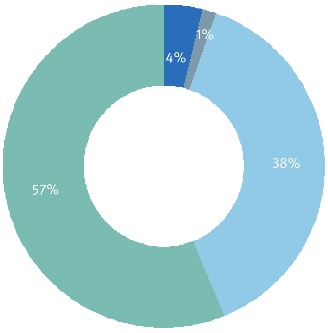
Address	Area (sq m)	Face Rental ($/m²)	Term (yrs)	Incentive (%)`	Lease Type	Tenant	Start Date
15 Green Close, Fortitude Valley	8,000	c540 g	10	Undis	Pre-commitment	Urban Utilities	Mid 13
825 Ann St, Fortitude Valley	6,568	530 g	10	Undis	Pre-commitment	Ergon Energy	Nov 12
30 Little Cribb St, Milton	1,167	485 g	5	< 20	New	CAE Australia	Jan 12
135 Wickham Tce, Spring Hill	495	450 g	5	20-25	New	MAP Funds Mgt	Dec 11
1 Breakfast Creek Rd, Newstead	2,562	465 g	5	25+	New	Bechtel	Nov 11
147 Coronation Dr, Milton	3,500	470 g	9	25+	New	Golder Assoc	Nov 11
144 Montague Rd, South Brisbane	5,666	495 g	4	Fitout	Sub lease	Origin Energy	Sept 11
400 Wickham St, Fortitude Valley	1,326	380 g	2	-	Expansion	Ergon Energy	Jul 11
349 Coronation Dr, Milton	1,082	425 g	6	20-25	New	OSD Pipelines	Jul 11
21 McLachlan St, Fortitude Valley	630	395 g	6	Fitout	New	E3 Consulting Australia	Jul 11
80-88 Jephson St, Toowong	2,000	450 g	4	20-25	New	Transcity	Apr 11
515 St Paul's Tce, Fortitude Valley	4,000	500 g	3	20-25	Expansion	Bechtel	Mar 11

Source: Knight Frank g= gross

INVESTMENT ACTIVITY & YIELDS

Investment activity across the Near City has continued to tick over since early 2011, with a number of sales in the sub $25 million price bracket. The most significant sale is expected to be the purchase of HQ North Tower by Cromwell. The building at 512 Wickham St, Fortitude Valley, is currently under contract to Cromwell for a reported $185 million and would be the largest transaction of 2011 to date by a significant margin. Since the sale of 179 Grey Street in late 2010 for $70 million, transactions in 2011 had all been under $25 million.

Figure 9
Brisbane Near City Purchaser Profile
Sales ›$3 million 12 months to November 2011



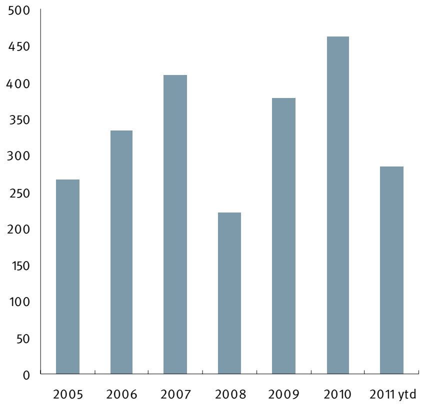
Source: Knight Frank

Private investors have continued to dominate the number of transactions with eight sales in excess of $3 million over the 12 months to October 2011. The $176.7 million from private investors was dominated by the 179 Grey Street, South Brisbane transaction outlined above. There has been some increased activity from unlisted funds, which includes both wholesale funds and syndicates, with four major sales over the past 12 months ($258.8million). The smallest was the Harvest Denison property purchase of 12 Cribb St, Milton for $13.3 million. In late 2010 Century Funds Management purchased 200 Creek St, Spring Hill for $37.7 million and more recently 1 Breakfast Creek Rd, Newstead was purchased by Prime West for $22.75 million.

ONLY ONE SALE OVER $25 MILLION 2011 YTD

Developers accounted for 4% of the transaction value over the past 12 months, through three sales. An increasing focus on the next round of commercial development has spurred this revival in development site purchasing activity, mostly by private investors.

Figure 10
Brisbane Near City Purchasing Activity
Total Transactions $ million (Sales ›$3 million)



Source: Knight Frank

Transaction levels for 2011 ytd are lower than for 2009 and 2010 where the Near City market recovered quite strongly after the lull in transaction activity during 2008. With just under $300 million in sales 2011 to date, this is 38% lower than the 2010 total with one quarter remaining. While transaction activity has remained slow, there has been sustained investor interest in the Near City market due to the structural changes the market has undergone in recent years, completely changing the occupier and investor profile.

Table 6
Recent Sales Activity Brisbane Near City

Address	Grade	Price ($ mil)	Core Market Yield (%)	NLA (m²)	$/m² NLA	WALE (yrs)	Vendor	Purchaser	Sale Date
HQ North, 512 Wickham St, FV	Prime	c185.00	8.35	29,821	6,203	6.7	Leighton Property	Cromwell	Contract
757 Ann St, FV	Site	4.00	Site	1,219`	3,281`	Site	Seymour Group	Vanriet	Oct 11
130 Commercial Rd, Newstead	Secondary	10.80	10.84	4,338	2,490	3.2	Dunlevy Group	Engage Capital	Oct 11
358 Wickham St, FV	Site	10.62	Site	2,192`	4,846`	Site	2 separate vendors	Private Investor	Jul 11
85 Hudson Rd, Albion	Prime	13.20	9.52	2,823	4,676	3.4	Urbex/ Dimension	Private Investor	Jun 11
1 Breakfast Creek Rd, Newstead	Prime	22.75	8.9	6,168	3,688	2.4	Trafalgar Group	Prime West	May 11
12 Cribb St, Milton	Secondary	13.30	13.3 ^	3,310	4,018	3.1	Mirvac	Harvest Denison Opportunity Fund	May 11

Source: Knight Frank FV = Fortitude Valley ` Site area and $/m² of site ^ initial yield

Yields for prime investment property have remained stable over the past six months, with only two prime sales recorded since Q1 2011. In the absence of defining sales we anticipate prime core market yields have remained largely unchanged at 7.60% - 8.70%, with a slight firming at the upper end of the range, reflecting improvements in sentiment surrounding vacancy and letting-up periods.

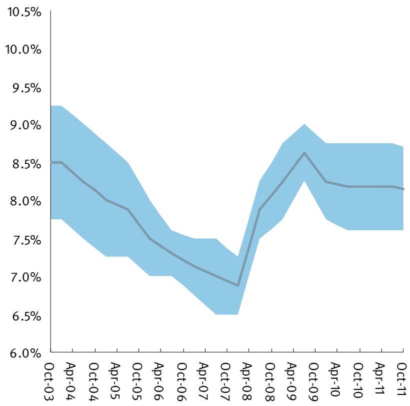
The lower yield range of 7.60% has not been challenged for some time, and reflects a prime building purchased while under construction or on a fund through basis, with an impeccable tenant profile and long WALE. Most improved sales remain above 8.25% within the current environment.

Secondary yields have remained largely unchanged covering a range of 8.75% to 9.50%. While the prospect for rental rates and potential for rental growth have improved during the course of 2011, the level of secondary space available in the market continues to be a risk to purchasers. Most secondary investments have been made by value-add investors who see future potential either through refurbishment, re-leasing or repositioning of the asset. The greater number of secondary sales over the course of the year indicates the gradually returning appetite for risk on the part of both purchasers and, more importantly, lenders.

Figure 11

Brisbane Near City Prime Yields

Prime Investment Yield Range & Median



Source: Knight Frank

OUTLOOK

Market conditions have steadily improved over the course of 2011 in the Near City commercial market. Continued global uncertainty regarding European financial stability, China's economic outlook and the degree of economic recovery in the USA, has impacted on confidence both here and abroad. For each economic stumble there is a corresponding dip in activity within the property market as decisions (whether to lease, buy or sell) are impacted by confidence.

Nevertheless, the leasing market has steadily improved with consistent demand from tenants under 2,000m². This trend is expected to continue, with sporadic boosts from larger tenants either expanding significantly or moving from the CBD into the Near City market. The next round of development, at the moment largely dependent on pre-commitments, will provide greater scope for the larger corporates to relocate into the Near City market.

Despite this expected steady demand, the net absorption levels are expected to be lower over the next 18 months than was the case during the period of high supply 2007 – 2010. While the supply levels were strong, the average net absorption per six month period was 31,000m² as the net absorption was aligned with tenants moving and expanding into the new accommodation. Over the next 18 months the average six monthly net absorption is forecast to be 16,700m², remaining relatively lower until the new supply comes on line, giving larger tenants the chance to take up new space within the market.

Tenant demand is expected to remain dominated by mining/energy companies, engineering and firms which service the mining industry. Additional potential tenants such as the Queensland Government, Suncorp, Bank of Queensland and Optus serve as a reminder that the Near City has a broader appeal than to just resource related tenants, no matter how much the market has been dominated by their growth.

Future demand is expected to be concentrated in prime space, with upgrading remaining a common theme for this market. With a large gap between the current generation buildings and established A-/B+ grade properties, the gap between prime and secondary rents will continue to widen.

Under the weight of steady demand and little supply in the coming year, rental growth is forecast to continue. Prime effective rental growth, driven by both increases in face rental levels and falling incentives is expected to be 8.0% for CY 2012 and a more modest 5.0% for CY 2013 as the supply additions build. Secondary space will also see continued growth in effective rental levels (largely through face rental appreciation) of 3.7% for CY 2012 and 5.1% for CY 2013. This growth in secondary rental levels assumes that some of the older properties are removed for redevelopment or re-use, given the generational change underway across the Near City stock.

NEAR CITY HAS A BROAD APPEAL; NOT JUST TO RESOURCE RELATED TENANTS

The capital market for the Near City is expected to remain quite stable over the short term, with conditions experienced during 2011 to date to continue. Given the investments currently being offered to the market there is some expectation that there will be more sales in excess of $25 million over the coming six months. Sales will remain relatively slow to conclude with investment demand for prime investments balanced by market caution.

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