RESEARCH

OCTOBER 2013

BRISBANE FRINGE

Office Market Brief

HIGHLIGHTS

- The Brisbane Fringe has continued to be subject to good tenant demand for new office space, although this is not necessarily transferring through to existing accommodation, particularly secondary space. The vacancy rate has increased to 11.8% as at July 2013 and is expected to continue to climb in the short term, before beginning to improve in 2014. Supply for the first half of 2013 was 50,834m², which is 75% committed. The second half of 2013 will see lower supply additions with 41 O'Connell Terrace, Bowen Hills at 7,104m² the only major completion.
- Net absorption in the first half of 2013 was supported by tenants relocating into the Fringe, largely from the CBD and thus recorded a positive result of 19,050m². Without the support of this factor, H2 2013 is expected to return to negative net absorption of -5,969m². The demand softness has continued to impact on rental levels with effective rents for existing space falling a further 9% for prime and 12.3% for secondary over the past 12 months.
- Investment demand has remained strong, particularly for new assets which offer good tenant covenants and long WALEs, however opportunities have been limited in the past six months. For top shelf investments there has been continued pressure for yield contraction, however for the wider market yields have remained quite stable over the past six months.

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Table 1

Brisbane Fringe Office Market Indicators as at October 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	582,796	8.6	28,058	50,834	500	29.0	7.90 – 8.50
Secondary	609,102	14.8	-23,368	-1,652	415	30.0	8.75 – 9.75
Total	**1,191,898**	**11.8**	**4,690**	**49,182**			

Source: Knight Frank/PCA ^ as at July 2013

Development Activity

The first half of 2013 saw new stock completions in the order of 50,834m², dominated by the completion of 15 Green Square Close, Fortitude Valley and early in the year the addition of 825 Ann Street, Fortitude Valley. The supply for the first half of the year is 75% committed with the 17,850m² 825 Ann Street and 16,302m² 15 Green Square Close both fully leased. The FKP developed Gasometer 1 and associated annex currently has leases in place over 36% of the office space with FKP subsidiary Aveo (700m²), Aegis Media (1,400m²) and AAco (1,200m²) all taking space. The speculatively developed 51 Alfred Street (7,482m²) remains without any announced tenant commitment at this stage.

The only additional supply which is expected to be completed during 2013 is 41 O'Connell Terrace, Bowen Hills which is in the final stages of construction. This 7,104m² building is 25% committed to the Legacy Way Tunnel Control Centre.

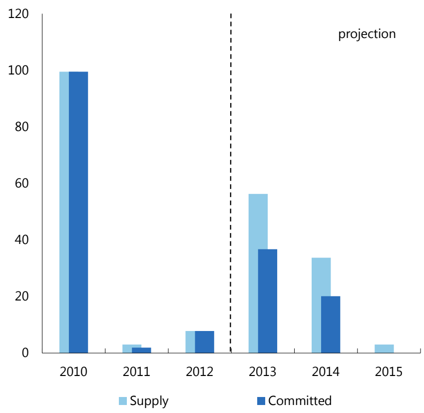
Completions during 2014 will be dominated by the 23,420m² Gasometer 2, Newstead which is 59% pre-committed to the Bank of Queensland. The project was purchased by a joint venture between Charter Hall Core Plus Office Fund and PSP Investments in May 2013. The other major construction is 757 Ann Street, Fortitude Valley where the 7,815m² building is 81% pre-committed to Ventyx. Both these pre-committing tenants are relocating from the Brisbane CBD.

At this stage construction during 2015 is expected to be more modest, dominated by smaller infill developments and office components of mixed use developments. However a number of projects can be delivered should tenant commitment be achieved in the short term. Supply is expected to accelerate again in 2016 via a number of major occupier-led projects, including the Tatts Group Head Office.

Figure 1

Brisbane Fringe Supply

('000m²) Supply (new & refurb) & commitment



Source: Knight Frank/PCA

Net Absorption & Vacancy

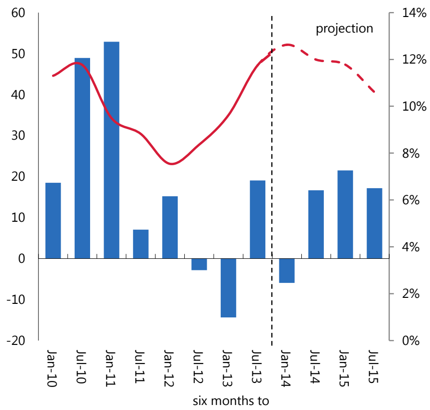
Net absorption within the Fringe market was supported over the first six months of 2013 by tenant relocations from the CBD (ie Urban Utilities, Laing O'Rourke) to be 19,050m², making it one of the few Australian markets to record positive absorption in the first half of 2013. However with no major relocations supporting the market for the second half of 2013, the net absorption is expected to return to negative territory at -5,969m² as tenant contraction is felt across the market.

The vacancy rate is expected to increase to 12.6% by the end of 2013, however begin a downward trajectory from there. With solid pre-commitment levels for the 2014 supply, which are also net gains for the Fringe market, the vacancy rate is expected to decline through the year, despite the solid supply levels. The current expectation of modest supply during 2015 will further assist to bring the vacancy back down towards 10% in mid-2015.

Figure 2

Brisbane Fringe Demand & Vacancy

('000m²) Net Absorption (LHS) & Vacancy Rate (RHS)

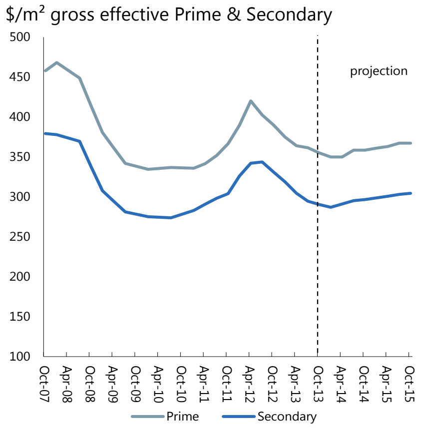


Source: Knight Frank/PCA

Tenant Demand & Rents

The modest demand levels across commercial markets have also had an impact within the Brisbane Fringe, with downward pressure on effective rents in evidence. In addition there remains competition from sub-lease space across a number of larger prime buildings. The prime gross face rents have softened slightly over the past six months to be $500/m², however the effective rental has softened by 9% over the past year as incentives have increased from 22% in October 2012 to currently be 29%. The gap between existing prime building rents and newly constructed stock has continued to grow, with new stock, depending on delivery date, priced at $570 – 625/m² gross face.

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



Source: Knight Frank

Secondary space is also struggling with average face rents falling 3.5% over the past year to $415/m² gross with incentives increasing from 23% to 30%, a fall of 12.3% in effective rents. Secondary rents are expected to remain stagnant into the medium term with increasing change of use for secondary assets.

Investment Activity & Yields

Investment activity within the Fringe market has been relatively modest over the past six months. The most significant transaction was the completion of the transfer of the Gasometer 2 site in Newstead to Charter Hall Core Plus Office Fund/PSP Investments for $18.72 million. The site was sold by FKP Commercial Developments following the 12,595m² pre-commitment by Bank of Queensland to 59% of the building, with the Charter Hall consortium choosing to take on the construction and leasing up risk on the project. Another significant site sale was the purchase by Tatts Group of the Joule site at 11 Breakfast Creek Rd, Newstead for $8.0 million. Tatts is intending to construct their own head office on the site.

Aside from those site transactions, completed activity has been dominated by smaller, B grade assets such as 121 Wharf Street, Spring Hill and 555 Coronation Drive, Toowong. Another Toowong asset, 74 High Street is also close to transacting. It is also understood that GPT are in due diligence to acquire 15 Green Square Close from CBIC for a yield which is understood to be sub-8%, however this sale has not yet completed.

Table 2
Recent Leasing Activity Brisbane Fringe

Address	Area (sq m)	Face Rental ($/m²)	Term (yrs)	Incentive (%)`	Tenant	Start Date
CB2, 100 Melbourne St, SB	5,762	560 g	10	25-30	Peabody Energy	Jun 14
Gasometer 1, Newstead	1,400	570 g	10	undis	Aegis Media*	Oct 13
CB1, 104 Melbourne St. SB	1,000	540 g	10	25-30	Toyota Tsusho	Sep 13
140 Melbourne St, SB	3,744	480 g	10	25-30	Qld Eye Institute	Sep 13
189 Grey St, SB	1,503	375 g	7	10-15	Titan Energy ~	Aug 13
10 Browning St, SB	1,327	495 g	3	30+	Credit Corp	Jul 13
515 St Pauls Tce, FV	1,969	516 g	3	Nil	Puma Energy	Jun 13

Source: Knight Frank g gross FV Fortitude Valley SB South Brisbane
`estimated incentive calculated on a straight line basis *Pre-commitment/new space ~ sub-lease

Outlook

The tenant demand for newly constructed or current generation office space has remained relatively strong within the Fringe market, with the Bank of Queensland commitment of 12,595m² in 2012 to be exceeded by the Flight Centre commitment of approx. 20,000m² to SouthPoint, expected to be formally announced shortly. Existing accommodation, particularly secondary space will continue to face sluggish rental conditions in the medium term.

Investment demand has remained strong, however the majority of the demand is for modern, well leased assets, which remain scarce within the market. For these top assets, investment demand is causing some narrowing of the yield gap between CBD and Fringe assets in this class. Across the wider market, yields have been stable and are expected to remain relatively static, hampered by the rental market uncertainty.

Table 3
Recent Sales Activity Brisbane Fringe

Address	Grade	Price ($ mil)	Core Market Yield (%)	NLA (m²)	$/m² NLA	WALE	Vendor	Purchaser	Sale Date
11 Breakfast Creek Rd, Newstead	Site	8.00	n/a	3,254#	2,459#	n/a	Watpac	Tatts Group	Sep 13
121 Wharf St, SH	B	24.00	8.96	4,443	5,402	6.2	GE Real Estate	Private Investor	Jul 13
555 Coronation Dr, T	B	28.50	9.11	5,618	5,073	2.7	AMP Capital	Sentinel Property	Jun 13
187 Melbourne St, SB	B	7.75	n/a ~	1,925	4,026	n/a	Qld Nurses Union	Aria Property	Jun 13
84 Longland St, Newstead	Site	18.72	n/a	5,992#	3,124#	n/a	FKP Commercial Developments	Charter Hall (CPOF) /PSP Investments	May 13

Source: Knight Frank ^ passing yield # Site Area and $/m² of site ~ sold 2/3rds vacant SH Spring Hill T Toowong SB South Brisbane

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