

An aerial photograph of the Brisbane Central Business District (CBD) showing a dense cluster of skyscrapers and office buildings. The city extends into the background with residential areas and green spaces. The text 'RESEARCH' is in the top left, 'Knight Frank' is in the top right, and 'BRISBANE CBD OFFICE MARKET OVERVIEW MARCH 2016' is overlaid at the bottom.

RESEARCH



BRISBANE CBD

OFFICE MARKET OVERVIEW MARCH 2016

HIGHLIGHTS

Tenant relocations are gradually increasing, with upgrading a strong motivator. With Tatts Group announcing a relocation into the CBD, the trend of tenants moving from other markets is beginning.

Average effective rents have been stable over the past year, at what is expected to be the cyclical low, with little to no change this year. Face rental growth is being balanced by further increases to incentives.

Investment demand for offices has remained high, driven by offshore purchasers. Although this demand has been focussed on the Sydney and Melbourne markets, Brisbane is increasingly being targeted.

KEY FINDINGS

Total Vacancy was 14.9% as at January 2016, down from 15.5% a year earlier. For this cycle the **peak is expected to be 18.6% in mid-2016**

Prime and secondary effective rents softened by 0.3% p.a and 0.1% p.a respectively as the rental market has stabilised, with little change expected over 2016

There have been indications of **greater leasing activity** from major corporates and the State Government, particularly in prime space, **but expansion is limited**

Yields remain under **downward pressure for core properties** and secondary properties with good leasing profiles, but are plateauing for assets with leasing exposure.



JENNELLE WILSON
Senior Director – Research QLD

SUPPLY & DEVELOPMENT

There are signs of improved leasing activity, however imminent supply completions will send the vacancy to peak levels mid-year. Withdrawal of older stock and no new supply will trigger improvement from late 2016.

There was very little change in total stock for the Brisbane CBD market in the six months to January 2016. There was no new stock added, with only a small return of refurbished space totalling 2,800m². Over the same period there was the withdrawal of 3,750m² due to 240 Margaret St being withdrawn for residential redevelopment.

This low supply environment will change markedly over the first half of 2016 with the completion of two major new buildings. Originally expected to be added to new supply in late 2015, 180 Ann St has reached practical completion with Commonwealth Bank in the early stages of relocation to the building. The 57,465m² building is now 53% committed after Tatts Group announced they would take 10 levels.

Completed mid-March, the second major 2016 supply addition is 480 Queen St. This 56,252m² building was developed by Grocon and onsold to DEXUS Property Group and DWPF. With the majority of pre-commitments to the building having been in place for some time, the only significant uncommitted space in the building is three low-rise podium floors.

1 William St will be completed in late 2016 and the 74,853m² building, fully committed to the State Government, will trigger obsolete building withdrawals.

With market metrics currently unsupportive of medium term speculative

office development, the next round of development is likely to be triggered by a major pre-commitment. The Shayher Group's 300 George St and ISPT's Regent are likely to headline the medium term potential supply.

Stock Withdrawal

Stock withdrawals during 2015 totalled 19,844m² of permanent withdrawals and a further 15,816m² was temporarily withdrawn for refurbishment (310 Ann St). Permanent withdrawals were made up of 363 Adelaide St (14,700m²), 171-175 Elizabeth St (1,394m² office component) and 240 Margaret St (3,750m²).

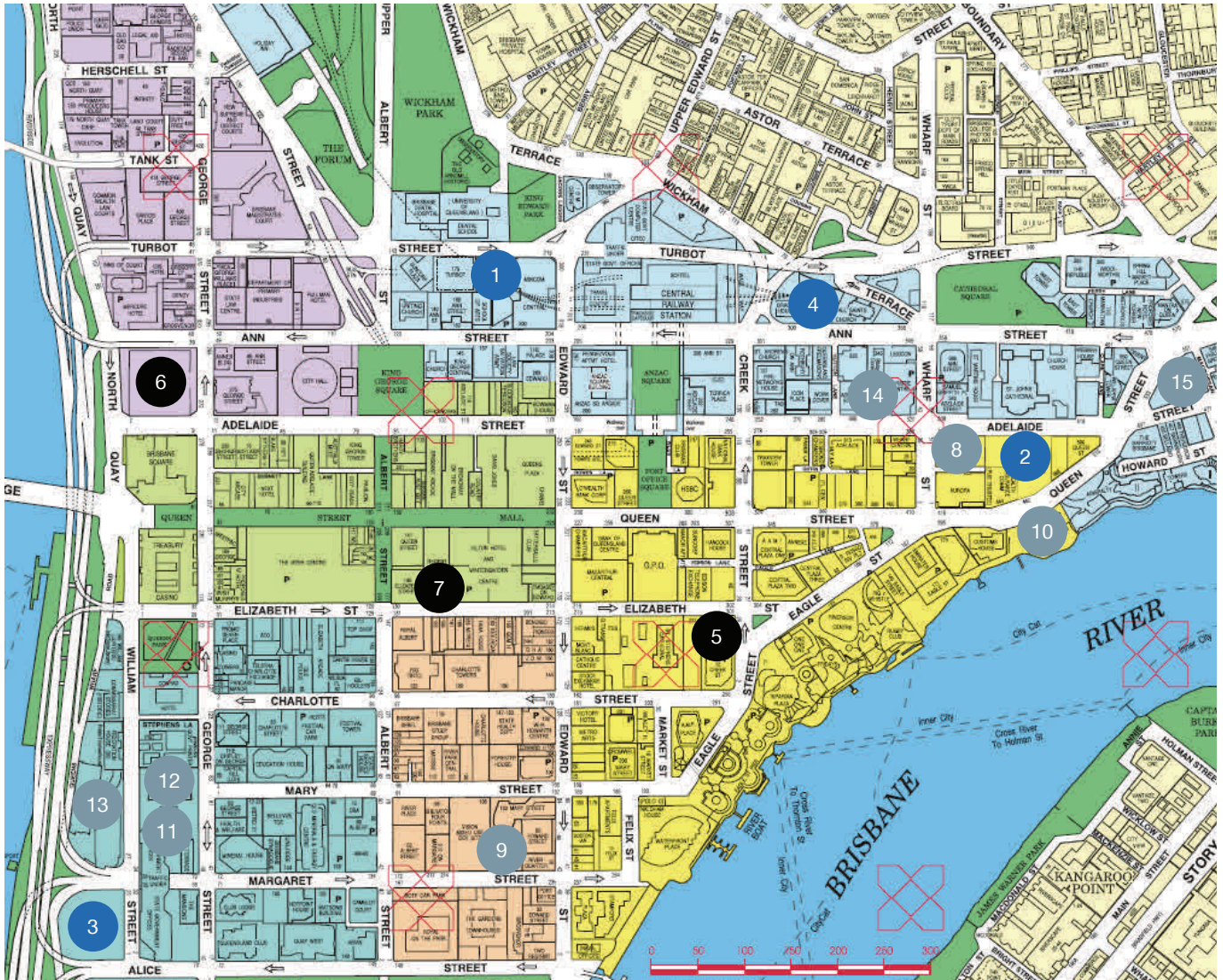
During 2016, permanent withdrawals are expected to accelerate to a potential total of 88,200m², but be concentrated in the latter part of the year. The dominant impact is the withdrawal for demolition of the three buildings which make up the Queens Wharf site, totalling 57,656m². These buildings will be withdrawn once State Government tenants relocate to 1 William St. Other expected significant withdrawals include 443 Queen St (5,560m² residential development), 316 Adelaide St (5,480m² conversion to student accommodation) and 545 Queen St (13,600m² residential development). The latter two buildings will be largely vacated by Flight Centre when they move to South Brisbane in the second half of 2016. Further withdrawals of circa 50,000m² are also possible beyond 2016 as alternative uses remain feasible.

TABLE 1
Brisbane CBD Office Market Indicators as at January 2016

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	1,068,373	11.0	-17,031	-15,816	704	37	6.10—7.20
Secondary	1,088,967	18.7	-865	-20,647	555	40	7.65—9.60
Total	2,157,340	14.9	-17,896	-36,463			

Source: Knight Frank Research/PCA

MAJOR OFFICE SUPPLY



- 1 180 Ann St—57,465m² [CBA/Tatts Gp] Daisho — Q1 2016—53% committed
- 2 480 Queen St—54,985m² office NLA [BHP/ PwC/Freehills] — 84% committed Grocon (DEXUS/DWPF) — Q1 2016
- 3 1 William St—74,853m² [State Govt] Cbus Property/ISPT—Q3 2016 100% committed
- 4 #310 Ann St—18,400m² Pidgeon Family—Q1 2017
- 5 12 Creek St Annex—6,297m² of GFA DEXUS Property Group/DWPF—tba
- 6 300 George St—46,895m² NLA Shayher Group—tba
- 7 150 Elizabeth St—c35,000m² ISPT—subject to pre-commitment
- 8 363 Adelaide St—14,700m² Valparaiso Capital —withdrawn Q1 2015 Student Accommodation Conversion

- 9 240 Margaret St—3,750m² Aspiat Corporation—withdrawal Q4 2015 Residential Development
- 10 443 Queen St—5,560m² Cbus— potential withdrawal 2016 Residential development
- 11 80 George St—16,150m² Queensland Government— 2016 Queens Wharf Integrated Resort Dev.
- 12 100 George St & annex —22,906m² Queensland Government— 2016 Queens Wharf Integrated Resort Dev.
- 13 75 William St—18,600m² Queensland Government— 2016 Queens Wharf Integrated Resort Dev.
- 14 316 Adelaide St—5,480m² MRL Capital—potential withdrawal 2016 Student Accommodation Conversion
- 15 545 Queen St—13,600m² Potential withdrawal 2016 Residential development

- Under Construction / Complete
- DA Approved / Confirmed / Site Works
- Mooted / Early Feasibility
- Former office buildings permanently withdrawn for change of use 2015 & forecast 2016

Source of Map: Knight Frank
 As at March 2016, excluding strata
 #major refurbishment
 Sub-lessor identified in *italics*.
 Avail office NLA quoted.
 Major Pre-commit in [brackets] next to the NLA.

TENANT DEMAND & RENTS

Leasing activity has continued to show tentative signs of improvement, however this is not uniform across the market and tenants remain with the upper hand. Overall the vacancy rate for the Brisbane CBD was stable over the six months to January 2016 at 14.9%, and down from 15.5% from January 2015. The modest growth conditions meant that while there has been some recent improvement in the vacancy rate it is not enough to insulate the market against the supply to come on line in the first half of 2016.

TABLE 2
Brisbane CBD – Vacancy Rates

Precinct	Jan 15	Jan 16
Premium	9.1%	9.6%
A Grade	11.1%	11.3%
Prime	10.7%	11.0%
B Grade	23.0%	19.4%
C Grade	12.1%	16.6%
D Grade	16.6%	17.8%
Secondary	20.5%	18.7%
Totals	15.5%	14.9%

Source: Knight Frank Research/PCA

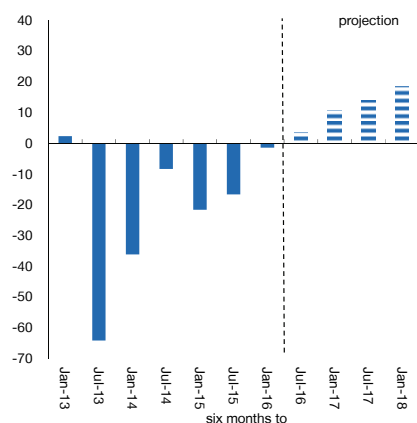
The prime market vacancy rate was 11.0% as at January 2016, up marginally from 10.7% a year earlier. However in a positive sign for the prime market the prime rate has reduced from 11.7% in mid-2015. As outlined above the new supply will see the prime vacancy increase, beyond 15%, in the short term as the backfill space is digested by the market.

Secondary vacancy was 18.7% as at January 2016 and while this is an improvement from 12 months earlier, that market remains fragile.

Net Absorption

The Brisbane CBD recorded negative net absorption of -1,323m² over the second half of 2015, which was the strongest six monthly result for the market in three years. The overall annual net absorption for CY2015 was -17,986m², weighed down by the weaker result in the first half of 2015.

FIGURE 1
Brisbane CBD Net Absorption
(’000m²) per 6 month period



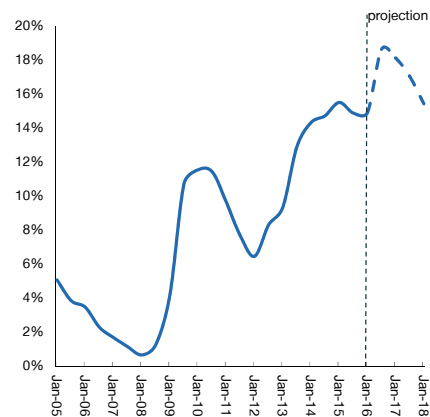
Source: Knight Frank Research/PCA

The prime market had positive net absorption of 7,902m² over the second half of 2015, led by the A grade market which recorded its strongest net absorption since late 2012. This is the first encouraging sign that the prime market is starting to see greater leasing activity—led by major corporates and the Government sector. Activity in the first quarter of 2016 has reinforced this trend, however the improvement is expected to remain tenuous through 2016.

Net absorption in the secondary market was -9,225m² in the second half of 2015, reversing a positive result in the first half of the year. With some further resource sector downsizing (ie Anglo Coal) to impact the market, plus tenants taking the opportunity to upgrade to prime space given the market conditions, and continued withdrawal of older stock, the secondary market is expected to record negative net absorption over 2016.

Net absorption as a whole is forecast to be slightly positive in the first half of 2016 influenced by factors such as the Queensland Government’s 7,760m² lease of space in 60 Albert St. The second half of the year will see a balance between positive factors like Tatts Group’s 18,000m² relocation into the CBD weighed against negative influences such as Flight Centre’s relocation from the CBD to the Fringe (-12,000m²). Net

FIGURE 2
Brisbane CBD Vacancy
% total vacancy



Source: Knight Frank Research/PCA

absorption is expected to begin to recover to long term average levels (20 year average is 11,245m² per six month period), over the course of 2017.

Vacancy

The vacancy rate will climb from the current 14.9% to 18.6% mid-2016 if both 180 Ann St and 480 Queen St are added to the stock base, as expected. The 112,450m² of new supply from these two buildings is currently 76,564m² committed with a further 35,886m² remaining available for lease. The tenants moving into these new buildings will leave some 43,300m² of backfill space within prime CBD buildings with a large proportion of this sub-lease space with tails of one to four years. The completion of 1 William St will have less of an impact on total vacancy with the 74,853m² addition to be somewhat balanced by the immediate withdrawal of 57,656m² of older State Government buildings.

The vacancy rate is expected to peak mid-2016 (dependent on the withdrawal timing of the ex-State Govt buildings) and then begin to reduce. A lack of any further major new supply in the medium term and an expected return to positive net absorption, will assist to bring the vacancy rate down. At this stage the vacancy rate is expected to return to current levels by early 2018.

Tenant Demand

With the Brisbane market on the cusp of receiving its largest influx of new stock in five years (the two new buildings for completion prior to July account for 5.1% of current total stock) tenant mobility is on the increase. Tenants are taking advantage of the upcoming peak in vacancy and associated strong negotiating position to upgrade their accommodation. Alternatively tenants in older buildings, slated for redevelopment, are being forced to seek new accommodation.

There has been steady demand from smaller tenants over the past year and these smaller, growing businesses have been particularly price sensitive. Secondary buildings that have been refurbished, added end of trip and good lobby facilities and have also offered speculatively fitted out suites have clearly absorbed the majority of this demand.

The announcement by Tatts Group that they would relocate into 18,000m² in the CBD, largely from the Fringe market is the first major indication of a long-awaited drift of tenants back into the CBD from other markets. The ability for tenants to upgrade their accommodation with little to no additional outlay, and a comparable or lower rent, is set to drive activity across the CBD over the course of 2016. Current active CBD requirements include Origin (c18,000m²), (Cooper Grace Ward (4,000m²), Arcadis (1,900m²) and Expedia (2,000m²).

Rental Levels

Across the Brisbane CBD, average effective rents have been stagnant over the past year. Face rents have increased, however this has been balanced by further growth in average incentive levels.

Prime gross face rents have increased by 1.6% over the past year to average \$704/m² as major landlords have been able to push face rents slightly. However the highly competitive nature of the tenant market has meant that this face rent growth has been balanced by a further increase to average incentives. Prime incentives now average 37.0%, up from 36.0% a year ago. Average gross effective rents are now sitting at \$444/m² which is only a slight reduction from \$445/m² one year ago. Forecasts for effective prime rents are modest with 0.3% growth to January 2017 to be followed by 2.5% to January 2018.

Secondary market rents have shown a similar pattern to the prime market with face rents subject to continued push-back from building owners. The gross face rents for the secondary market, on average, are sitting at \$555/m² which represents growth of 1.8% over the past year. In the aftermath of the reduction of resource sector activity the secondary face rents fell to as low as \$520/m² in mid-2013 and they have since shown some improvement, most of which in the past 12 months. Face rents have now increased to levels last seen in mid-2012.

“Signs are emerging of an uplift in prime leasing activity – due to major corporates and the State Government”

However the incentives within the secondary market have continued to increase and as a result the effective rents have softened. Average secondary incentives are 40%, up from 39% a year ago which results in a gross effective rent of \$333/m², which reflects no change from a year prior. The average secondary rents are expected to be at the same levels in January 2017 and a modest 0.9% higher in January 2018. While the total vacancy in the secondary market is expected to remain high, the works undertaken by the majority of owners to improve their building fabric along with the inferior stock being removed from the market for redevelopment, will ensure the stabilisation of average rents.

TABLE 3

Recent Leasing Activity Brisbane CBD

Address	NLA m ²	Face Rent \$/m ²	Term yrs	Incentive (%)`	Tenant	Start Date
180 Ann St	18,000	undis	15	undis	Tatts Group	undis
200 Mary St	1,786	560 g	5	35-40	LogiCamms	Oct 16
333 Ann St	1,300	585 g	5	undis	Mastercard	Aug 16
155 Queen St	2,100	undis	7	undis	Brisbane Marketing	July 16
60 Albert St	7,706	undis	8	undis	Queensland Govt	Dec 15
10 Eagle St	911	c700 g	5	35-40	Cubic Transport	Nov 15
369 Ann St	1,400	495 g	7	30-35	Sage Institute	Aug 15
295 Ann St	2,427	575 g	10	35-40	ABS	Jul 15

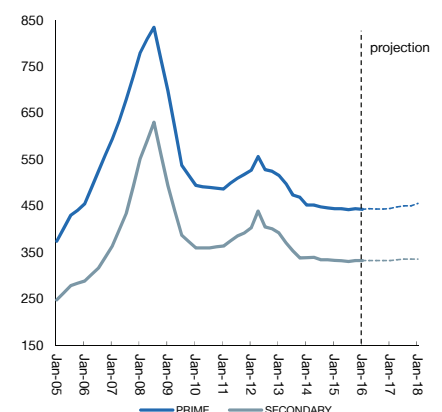
`estimated incentive calculated on a straight line basis g gross

Source: Knight Frank Research

FIGURE 3

Brisbane CBD Rents

\$/m² p.a average gross effective rent



Source: Knight Frank Research

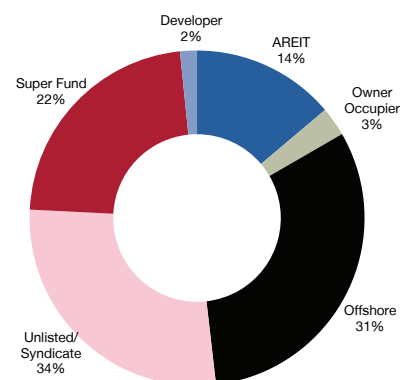
INVESTMENT ACTIVITY & YIELDS

Purchasing demand has remained strong across the national office investment market, although activity has been concentrated in Sydney and Melbourne. Investment across all Australian office markets totalled \$15.91 billion in 2015 with Sydney (57%) and Melbourne (24%) dominating total investment turnover. The Brisbane market accounted for 12% of total turnover with \$1.91 billion, of which \$1.22 billion was from sales within the CBD. A lack of formally marketed prime assets in the Brisbane CBD has contributed to the relatively lower turnover levels, however the second

wave of offshore investor interest has only just begun to flow over from the gateway cities to the Brisbane market.

Over the past two calendar years offshore investment has accounted for 31% of turnover within the Brisbane CBD, second only to the active unlisted/syndicate sector. Offshore purchasers have been attracted to value add and redevelopment projects, with some reticence still evident to enter the Brisbane market in larger \$250 million+ prime investments. This appears to represent too great an exposure for an investment hold for the majority of offshore buyers, however there are a number of CBD residential projects being undertaken by offshore developers which have a total investment well above this level.

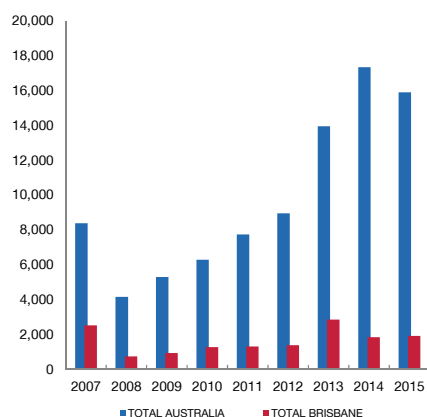
FIGURE 5
Brisbane CBD Purchaser Profile
CY 2014 & CY 2015 combined



Source: Knight Frank Research

The headline sale for 2015 was the \$635 million purchase of 1 Eagle St (Waterfront Place) and the adjoining Eagle Street Pier. This was purchased jointly by the listed DEXUS Property Group and the DEXUS Wholesale Property Fund. This sale accounted for the only AREIT purchase in the Brisbane CBD during 2015 and a large proportion of the unlisted/syndicate sales. Super Funds accounted for 22% of transaction turnover over the past two years, dominated by Challenger Life which purchased 53 Albert St (\$209.27 million in late 2014) and 215 Adelaide St (\$224 million in 2015).

FIGURE 4
Office Market Investment (\$10m+)
\$ million Total Australia v Total Brisbane



Source: Knight Frank Research

Offshore investment during 2015 was dominated by Deutsche Asset Management's purchase of 313 Adelaide St for \$125.40 million. In early 2016 there has been greater activity with offshore buyer Basil Property Trust via AEP Funds Management purchasing the value-add 41 George St (\$159.80 million) and it is understood that a Hong Kong entity is the buyer of 545 Queen St, which represents a major redevelopment project. It is also expected that further offshore investment will be in evidence during the first half of 2016.

TABLE 4
Recent Sales Activity Brisbane CBD

Address	Grade	Price \$ mil	Core Market Yield %	NLA m ²	\$/m ² NLA	WALE yrs	Vendor	Purchaser	Sale Date
545 Queen St	B	82.00	7.75	13,400	6,119	1.5	GPT Wholesale Office Fund	Undisclosed offshore purchaser	Aug 16#
41 George St	B	159.80	8.58	29,960	5,334	5.2	QIC	Basil Property Trust (AEP Investment Mgt)	Jan 16
201 Charlotte St	B	81.57	7.91	13,438	6,070	4.4	Private Investor	Fortius & Blackrock	Dec 15
313 Adelaide St	A/B	125.40	6.84	14,592	8,594	4.1	Private Investor	Deutsche Asset Management	Nov 15
1 Eagle St & Eagle Street Pier	P	635.00	6.90*	65,706*	9,664*	4.2	Stockland Group & Future Fund	DEXUS Property Group & DWPF	Oct 15

contracted late 2015 with August 2016 settlement, reported yield. Residential development proposed on the site

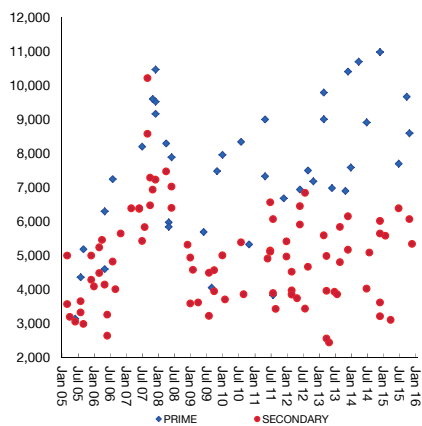
* Blended rates across both the office tower and Eagle Street Pier

Source: Knight Frank Research

Despite the relatively low total investment turnover within the Brisbane CBD, the lack of opportunities has seen transactions achieved at generally strong pricing levels. As shown in Figure 6, on a simplistic improved rate basis, the market has recovered to pre-GFC peak levels for prime assets.

Prime yields have continued to firm, drawn down by the overall investment demand and spread to the Sydney (132bps) and Melbourne (127bps) markets. Particularly for modern assets which provide a WALE which takes the building beyond the expected short term weakness in the leasing market, yields have yet to find their floor. Overall prime Brisbane CBD yields range between 6.10% - 7.20%, a reduction of 20bps on average over the past year.

FIGURE 6
Brisbane CBD Sales
\$/m² of NLA for sale \$10 million+



Source: Knight Frank Research

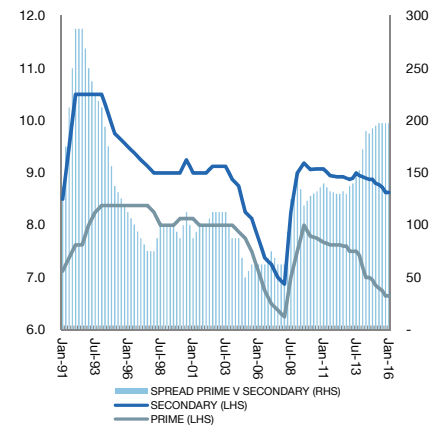
Secondary yields, on average, have tightened by 18 basis points over the past 12 months due to an increase in demand for value add and/or sub-\$150 million assets. With a yield range of 7.65% - 9.60% there is a wide value range for secondary assets, dependent on the lease profile and WALE of the building.

As shown in Figure 6, the spread of improved rates for secondary assets is large, with values generally below those achieved during the peaks for the secondary market in 2007 and to a lesser extent 2012 (when secondary rents were at their peak).

With the secondary yields lagging and the prime yields firming, the spread between prime and secondary core market yields is now at a 22 year high at 197 basis points (Figure 7). This disparity shows no signs of reducing as despite the strong investment demand, secondary assets with exposure to leasing risk in the next three years will be priced more harshly by the market. At the other end of the scale secondary assets which have conversion potential or value-add opportunities in a location undergoing or expected to undergo renaissance in the coming years (ie surrounding the Queens Wharf precinct) have been popular with investors.

With the cost of commercial debt beginning to increase out of pace with official cash rates the downward pressure on yields is expected to abate somewhat over the course of 2016.

FIGURE 7
Brisbane CBD Core Market Yields
% Yield LHS & Basis Point Spread RHS



Source: Knight Frank Research

Outlook

- While tenant demand remains fragile there are indications in the market of a period of greater relocation activity ahead. The prime market has shown some promising signs over the past six months with both major corporates and the State Government more likely to relocate.
- Vacancy is expected to peak at 18.6% in mid-2016 after 180 Ann St and 480 Queen St enter the market. Due to aligned withdrawals the impact of 1 William St will not be as significant.
- Effective rents are expected to maintain recent levels, with the potential for incentives to grow beyond average levels for selected buildings impacted by backfill vacancy. Effective rents are going to be stable during 2016 on average, and are considered to have reached their low point, with improvement to prime effective rents to emerge from mid-2017.
- The withdrawal of older stock will peak during 2016, weighted towards the end of the year, with 88,200m² of stock to be withdrawn (4% of current stock). A further c50,000m² will potentially be withdrawn during 2017.
- The total quantum of sales within the Brisbane CBD has been stable over the past two years, but lower than the record levels of 2013. The influx of offshore buyers have been focussed on the Sydney and Melbourne markets to date, however there is the potential for this demand to spill over to Brisbane.
- Yields have remained under downward pressure and for core assets this will remain in force. With the lower yields in Sydney and Melbourne now being supported by effective rental growth across both prime and secondary markets, the spread between Brisbane and these cities will be maintained for all but core assets.

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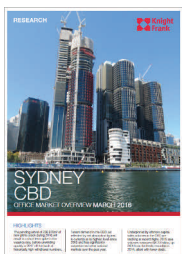
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