RESEARCH

BRISBANE CBD

OFFICE MARKET OVERVIEW APRIL 2018

HIGHLIGHTS

The market is focussed on larger tenant activity which will both provide a short term boost to net absorption and also trigger additional new supply in the medium term.

Effective rents have continued to appreciate as the market has moved further into recovery. The recent increase to the vacancy rate will be eroded by mid-year as tenant relocations take effect.

Investor interest has continued to increase for the Brisbane CBD, leading to increased transaction levels and prime yields beginning to move closer to Sydney/Melbourne after being at record spreads.

KEY FINDINGS

From **total vacancy of 16.2%** at the start of 2018 the Brisbane CBD will see improvement, moving **to sub 13.5%** by the end of the year.

Prime and secondary effective rents grew by **3.4% p.a and 3.0% p.a** respectively in the year to April 2018; with continued steady growth anticipated.

While the number of **potential new developments has increased,** due to larger tenants having space requirements, the actual delivery is expected to **remain staggered from 2021+.**

Limited on-market asset availability along with ever-**increasing investor interest** has resulted in further **yield compression** across both prime and secondary assets.

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SUPPLY & DEVELOPMENT

2018 will be devoid of new supply, after additions of only 18,303sqm in 2017. Despite only one project currently under construction, there is a significant pipeline of future development slated for the CBD.

Net supply was negative during 2017 and will remain so in 2018

The Brisbane CBD is in the midst of a hiatus in stock delivery, which is assisting the market to retreat from cyclically high vacancy rates. During 2017 net additions to stock were negative with the return of the refurbished 310 Ann St (18,303sqm) outweighed by 42,642sqm of secondary stock withdrawals. These stock withdrawals were the final stage of the State Government's major relocation into 1 William St in late 2016. The withdrawals consisted of:

- 80 Ann St removed from stock for expected demolition (14,429sqm),
- Health and Forestry House withdrawn for major refurbishment/ redevelopment (26,713sqm), and
- The Mansions (1,500sqm) withdrawn for change of use as part of the Queens Wharf development.

Net supply is expected to remain negative during 2018 with no major completions expected. Withdrawals of obsolete stock will continue with likely withdrawals of 9,200sqm to create the 360-380 Queen St site and the likely resumption of Transit Centre West Tower (17,377sqm) and smaller Albert St buildings to enable Cross River Rail construction. The timing of these withdrawals is not yet confirmed, however is expected to occur over the course of 2018 and 2019.

Supply delivery likely to ramp up from 2019

While there is currently only one major CBD office project under construction, 2018 is expected to see the progression of a number of other projects.

The Shayher Group's 300 George St remains under construction and will deliver 47,000sqm of office space H1 2019. At this stage no commitments to the space have been announced.

Dexus is expected to speculatively begin construction on a boutique c6,600sqm development at 20 Creek St prior to mid-2018, with completion in H2 2019.

Medium term, the potential development pipeline has been growing with the Suncorp requirement drawing a number of developments back into the spotlight. Additionally, there is anticipated further demand from the State Government to upgrade accommodation, plus the overall market requirement for new stock to target major tenant expiries 2020+.

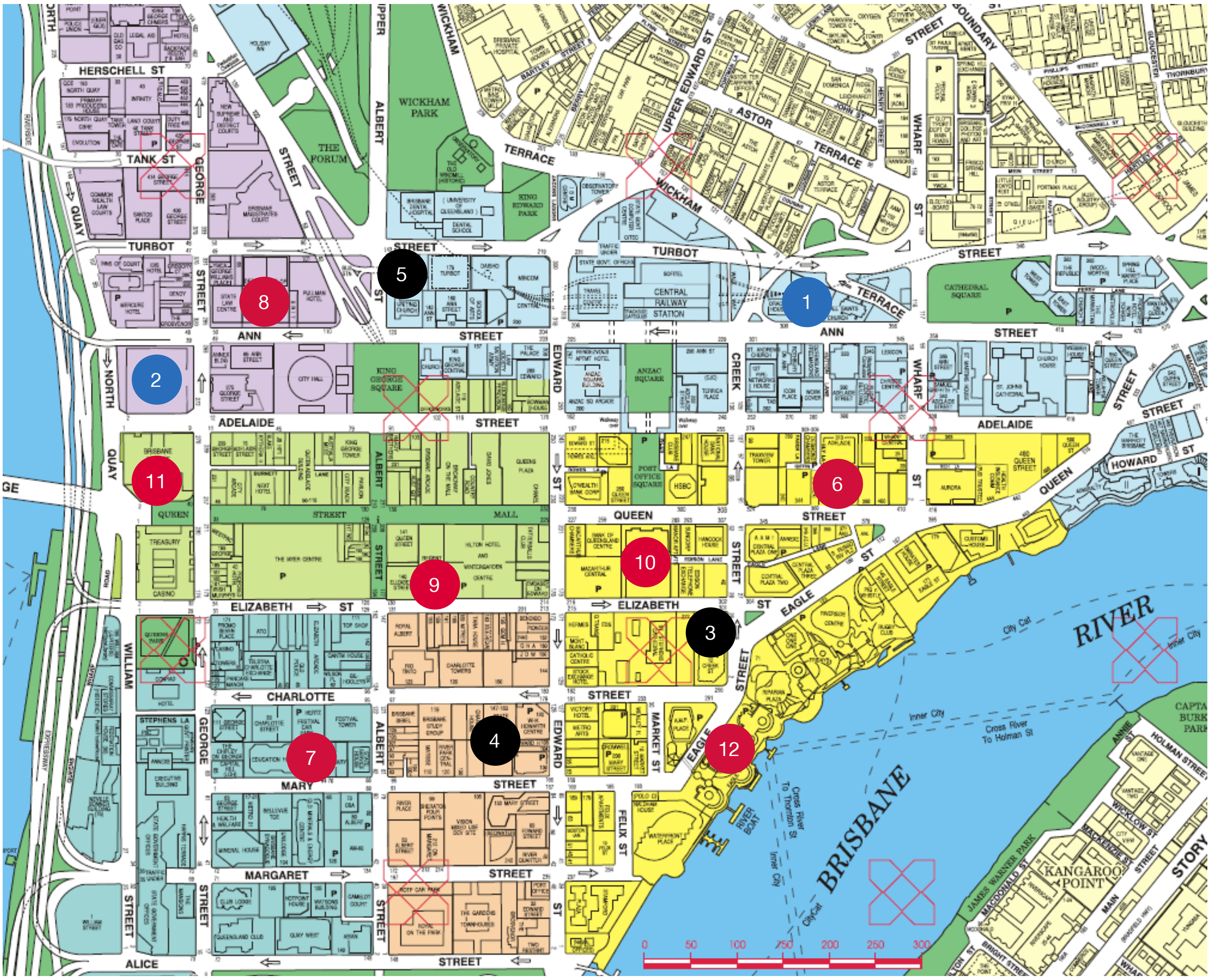
There is currently 266,750sqm of potential office space in projects either with recent development approval or active development applications (See page 3). With a number of these projects chasing the same tenants in Suncorp and State Government, the delivery of these projects is expected to remain staggered with only the Midtown Centre having the ability to be completed prior to 2021.

TABLE 1
Brisbane CBD Office Market Indicators as at April 2018

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	1,272,103	12.9	5,232	18,303	742	35.5	5.40—6.50
Secondary	983,283	20.6	-46,111	-42,972	570	38.8	6.60—8.50
Total	**2,255,386**	**16.2**	**-40,879**	**-24,669**			

Source: Knight Frank Research/PCA ^as at January 2018 *WALE 4-6 years

MAJOR OFFICE SUPPLY



- **1** #310 Ann St—18,303m²
  Pidgeon Family—Q3 2017
  89% committed
- **2** 300 George St—47,000m²
  Shayher Group—H1 2019
- **3** 20 Creek St— c6,600m²
  Dexus Property Group/DWPF—
  H2 2019
- **4** #Midtown Centre 155 Charlotte St & 150 Mary St^—42,000m²
  Ashe Morgan—H1 2020+
  Development Approval
- **5** 143 Turbot St/343 Albert St—50,160m²
  Amalgamated Property Group—
  Development Approval (unlikely to proceed, sitting tenant re-committed)
- **6** 360-380 Queen St—c55,000m²
  Charter Hall POF & ICPF—
  Development Application
- **7** 62 Mary St—38,000m²
  QIC—Development Application
- **8** 80 Ann St—c75,000m²
  Mirvac—Development Application
  (site under option)
- **9** 150 Elizabeth St—c42,000m²+
  ISPT—subject to pre-commitment
- **10** GPO Airspace
  Aust Post/Lend Lease/Eureka
- **11** Brisbane Square 2
  Charter Hall
  Planning Application Refused
- **12** Waterfront Precinct - Office component tba
  Dexus Property Group
  Masterplanning/ Market Led Proposal

- Under Construction / Complete
- DA Approved / Confirmed / Site Works
- Development Application/ Mooted / Early Feasibility

Source of Map: Knight Frank
As at April 2018, excluding strata
#major refurbishment
^formerly known as Health & Forestry House
Avail office NLA quoted.
Major Pre-commit in [brackets] next to the NLA.

TENANT DEMAND & RENTS

The formal PCA vacancy figures were disappointing, but are lagging activity

While sentiment and tenant activity in the Brisbane CBD steadily improved during 2017, this was not reflected in the January 2018 PCA Office market survey results. The Brisbane CBD total vacancy rate increased from 15.7% to 16.2% in the six months to January 2018, remaining below the cyclical high of 16.9% recorded in July 2016.

The prime market (made up of Premium and A Grade) recorded an increase, taking the vacancy rate to 12.9%, up from 11.7% six months earlier. This increase in prime vacancy was largely due to the return to the stocklist of the refurbished 310 Ann St (18,303m²) and Telstra downsizing in 275 George St (c7,000m²). These increases have now largely been unwound with 310 Ann St committed for all but two floors (89% leased) and 5,200m² taken by the State Government in 275 George St.

Despite the increase in the prime vacancy rate, net absorption was positive for the prime market at 2,377m² for the six months with both premium (518m²) and A Grade (1,859m²) recording growth in occupied space.

The blended secondary vacancy rate was stable at 20.6% as at January 2018. The vacancy rate remained stable despite negative net absorption of –37,741m² as vacant, obsolete buildings were removed from stock— ie 80 Ann St.

The B Grade market's total vacancy increased to 22% as at January 2018. This can be attributed to the withdrawal of Health & Forestry House, previously fully occupied, reducing the base of occupied stock in the market by 26,713m². Additionally, NAB has completed its relocation from 100 Creek St, upgrading to 259 Queen St, leaving c11,000m² of vacancy. Together these two impacts were a large part of the negative net absorption of –35,662m² within the B grade market.

TABLE 2
Brisbane CBD—Vacancy Rates

Precinct	Jan 17	Jan 18
Premium	12.2%	12.0%
A Grade	11.9%	13.2%
Prime	**12.0%**	**12.9%**
B Grade	19.7%	22.0%
C Grade	19.6%	16.6%
D Grade	15.3%	17.4%
Secondary	**19.4%**	**20.6%**
Totals	**15.3%**	**16.2%**

Source: Knight Frank Research/PCA

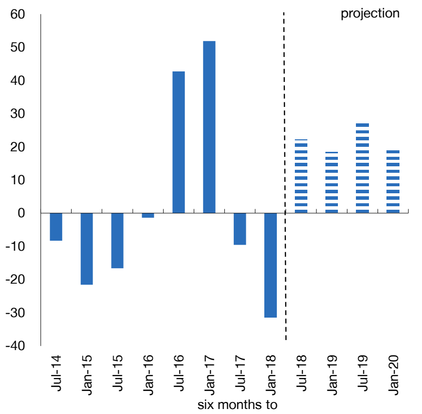
Short term net absorption will be boosted by tenants new to the CBD

Over the course of 2018 the greatest determinant of net absorption will the impact of significant tenants new to the CBD. Major tenants moving markets into the CBD include Origin (16,250sqm, Milton), Allianz (8,000sqm, Toowong) and State Government (13,200sqm, Woolloongabba). While this will be partly balanced by Aurizon (16,250sqm) and Aurecon (11,500sqm) moving to new accommodation in the Fringe, the overall impact on the CBD will be positive. Additionally there have been a number of tenants new to Brisbane or with new facilities including The Hub Australia (3,900sqm), Christie Corporate (3,500sqm) and Cross River Rail Authority (3,000sqm). With WeWork expected to shortly announce a significant commitment to the Brisbane CBD, this provides sustained indications of growing demand for the market and is supportive of forecasts of positive net absorption for 2018 and 2019.

At the same time the improved economic sentiment, increased investment in infrastructure, the progression of major projects and increasing population growth are all supporting sustained organic growth in office demand over the next five years. Forecasts for white collar employment indicate a 12% gross increase in white collar employment within the CBD in the next five years. Over 80% of this growth is expected to derive from the Public Administration and Professional & Technical services sub-sectors which are traditional strengths for the Brisbane market.

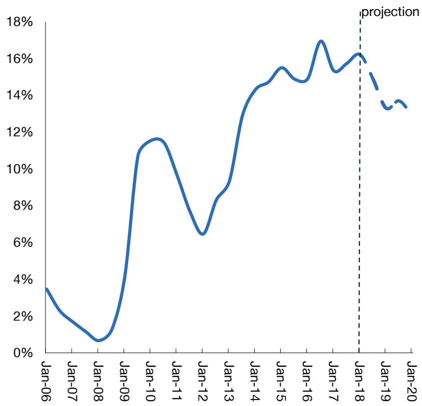
However the recent activity within the Brisbane market of The Hub Australia, Christie Corporate and WeWork is indicative that the tenant base is expanding into more non-traditional tenant types and Brisbane is likely to follow Sydney with a greater focus on attracting technology and media industry tenants.

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



Source: Knight Frank Research/PCA

FIGURE 2
Brisbane CBD Vacancy
% total vacancy



Source: Knight Frank Research/PCA

Large tenant moves are the focus of the market

Market attention remains focussed on the Suncorp requirement with the shortlist reportedly now down to two projects. With the 40,000sqm core requirement (plus 10,000m² of future/flex space) likely to trigger a new CBD building, Suncorp's expiry in their key premises of October 2021 gives an ever-tightening timeframe.

Additionally the State Government still has considerable leases within secondary assets. The major focus is on the full building leases of 50 Ann St (25,382sqm) and 41 George St (29,962sqm) which expire in 2020 and 2021 respectively.

These two occupiers are the focus of developer activity and may draw new supply to the market ahead of the vacancy rate reaching a level which would traditionally trigger supply. However this tenant-triggered new construction remains a 2021+ timeframe.

While larger tenants have been in the limelight, including Westpac which is expected to announce a c6,000sqm deal shortly, there has also been continued greater levels of activity at the smaller end of the market. Sub-500sqm tenants have continued to take advantage of the ever-increasing choice of speculatively developed suites with faster take-up of space the major benefit to owners. Additionally there has been continued good activity in 1,000—5,000sqm size range, as shown in Table 3.

Vacancy is forecast to begin a slow, steady decline during 2018

The anticipated return to substantial positive net absorption during 2018, along with further withdrawal of obsolete stock, is expected to be the catalyst for total vacancy to be sub-13.5% by the end of 2018.

While the completion of 300 George St will see the total vacancy tick-up in response in H1 2019, the recovery in vacancy will continue. Further major tenant relocations from other markets into the CBD have the potential to accelerate vacancy reduction, along with potential deferment of the projected new building construction.

Led by A grade space, with vacancy likely to fall below 10% during 2018, the prime market vacancy will reach towards market balance levels well in advance of recovery in the secondary market. While there are a number of obsolete buildings within the CBD the current relative lack of demand from alternative uses ie residential, hotel and student accommodation has the potential to delay the recycling of these buildings, instead channelling investment into their refurbishment as office stock.

Effective rental growth is established and will continue at a modest pace

Prime gross effective rents in the Brisbane CBD market troughed in April 2016 and have since recorded two years of steady growth (gross increase of 7.6%) with the majority of improvement coming from face rent. As at April 2018 the average prime gross face rent is $742/sqm, reflecting 1.8% p.a growth. Over 12 months, the average prime incentive has reduced from 36.5% to 35.5% as at April 2018, translating into gross effective rental growth of 3.4%. Continued improvement to the leasing environment is forecast to convert into annual effective rental growth of between 4.0% and 6.0% over the next three years.

The secondary market was slower to show improvement, with material growth emerging from early 2017. In the main, this increase has come from face rents being pushed within secondary assets that have undergone significant refurbishment and speculative fitouts. The current gross face rent of $570/sqm is 1.8% higher over the past year and incentives, while stubbornly high, are currently 38.8% on average, down from 40% at the start of 2017. Together these impacts have resulted in secondary gross effective rental growth of 3.0% p.a to April 2018. The next three years are expected to show gross effective rental growth of c4.0% p.a as improvements to the stock base continue.

TABLE 3

Recent Leasing Activity Brisbane CBD

Address	NLA m²	Face Rent $/m²	Term yrs	Incentive (%)`	Tenant	Start Date
200 Adelaide St	3,900	595	10	35-40	The Hub Australia	Nov 18
240 Queen St	1,017	710	10	35-40	Clarke Kann	Oct 18
1 Eagle St	1,822	840	7	30-35	Aust. Digital Health	Oct 18
310 Ann St	8,050	undis	10	35-40	Allianz	Oct 18
275 George St	5,200	725	7	35-40	State Govt	Jun 18
310 Ann St	7,200	undis	8	35-40	State Govt	Jun 18
123 Albert St	3,026	785	5	30-35	Cross River Rail Auth.	Apr 18
316 Adelaide St	1,100	570	7	35-40	Equifax	Mar 18

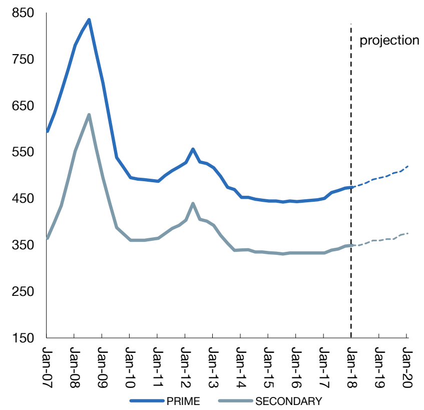
`estimated incentive calculated on a straight line basis g gross

Source: Knight Frank Research

FIGURE 3

Brisbane CBD Rents

$/m² p.a average gross effective rent



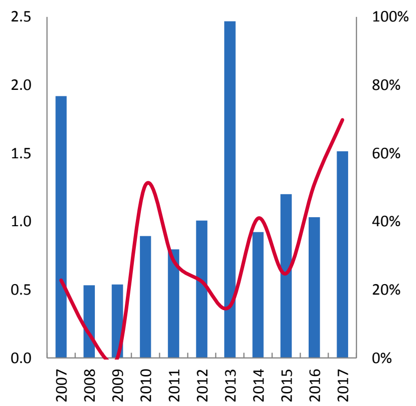
Source: Knight Frank Research

INVESTMENT ACTIVITY & YIELDS

The high investment activity was dominated by offshore buyers

The increase in investor demand for the Brisbane CBD market was reflected in the high transaction levels recorded during 2017. Total investment in the CBD (for assets $10m+) was $1.51 billion, the highest in four years. In terms of total transaction activity 2017 was the third highest recorded for the Brisbane CBD market, behind only the standout years of 2007 and 2013.

FIGURE 4
CBD Office Investment ($10m+)
$ billion CBD total & % turnover offshore buyers



Source: Knight Frank Research

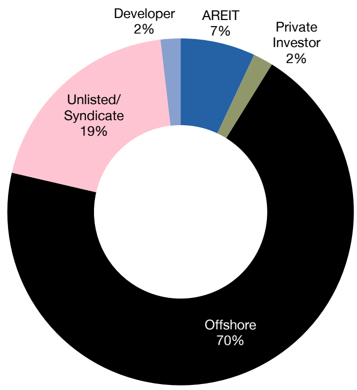
Offshore buyers dominated activity, accounting for 70% of the transactions by value, as domestic buyers were largely outbid. The only other investor class to show significant activity were the unlisted funds and syndicates with 19%.

The offshore purchasing occurred through six major transactions with the large offshore institutional investors of LaSalle Investment Management, Deutsche Asset Management, Goldman Sachs, Blackrock, Keppel REIT and GIC all active during 2017. Unlike Sydney and Melbourne offshore buyers have largely been limited to institutional buyers, with limited high net worth offshore buyers extending into the Brisbane market.

The largest sale was GIC's purchase of 32 Turbot St for $370 million

A GIC fund, acting through Charter Hall, purchased 32 Turbot St in late 2017 for $370 million, the largest transaction for the year. The A grade, 34,699sqm building was sold by Permodalan Nasional Berhad (PNB) for a core market yield of 5.7%. The neighbouring asset of 400 George St had a 50% interest in the asset transact for an apportioned $210 million as part of a portfolio transaction. Blackstone purchased the portfolio from South Aust Motor Accident Commission.

FIGURE 5
Brisbane CBD Purchaser Profile
2017



Source: Knight Frank Research

There were a further five sales between $100-150 million transacted in the CBD during 2017 which represents the sweet spot for many offshore and first time buyers in the Brisbane CBD. 307 Queen St ($142.15m La Salle IM), 120 Edward St ($142.65m Deutsche Asset Mgt), 50 Ann St ($144.62m Propertylink/Goldman Sachs), 160 Ann St ($119.50m Keppel REIT) and 150 Charlotte St ($105.75m Australian Unity Office Fund) were all B grade or low A grade assets largely attractive due to short term or medium term value–add opportunities for investors.

TABLE 4
Recent Sales Activity Brisbane CBD

Address	Grade	Price $ mil	Core Market Yield %	NLA m²	$/m² NLA	WALE yrs	Vendor	Purchaser	Sale Date
32 Turbot St	A	370.00	5.70	34,369	10,757	4.0	PNB	GIC/Charter Hall	Nov 17
147 Charlotte St & 146 Mary St	B	66.00	n/a#	26,651	2,439	0.6	Cromwell Property Group	Ashe Morgan Group	Nov 17
150 Charlotte St	B	105.75	5.96	11,011	9,604	5.5	CIMB Trust Capital	Australian Unity Office Fund	Oct 17
400 George St (50%)	A	210.00*	c6.50	43,493	9,657	3.5	Motor Accident Commission SA	151 Property Group (Blackstone)	Jul 17
160 Ann St	B	119.50	5.97	15,984	7,476	9.4	CorVal	Keppel Capital	Jul 17
366-380 Queen St	Site	53.75	n/a	2,147~	25,035~	n/a	Three adjoining owners	Charter Hall POF & Investa ICPF	Jun 17

Source: Knight Frank Research ~site and $/m² of site the three buildings on the site have an NLA of approx 9,400m² *allocated price as part of a major portfolio sale

Firming prime yields brings Brisbane to Sydney spread back down to average levels

Prime and secondary yields continued to firm during late 2017, and while there were no settled sales in the first quarter of 2018, anecdotal evidence from transactions underway indicate the firming trend remains. With demand for core assets high, but limited prime buildings available, median prime yields have fallen to a range of 5.40% - 6.50%.

The increasing focus on Brisbane and additional competition from major offshore buyers has caused the median prime yield to contract by 50 basis points (bps) over the past 12 months. This has eroded the historically high prime yield gap between Brisbane and Sydney, which peaked at 135bps during H1 2017, and has now reduced back towards the long term average of 100bps. With both Melbourne and Sydney having stronger leasing fundamentals, this reflects the level of 'catch-up' in investment demand, with buying mandates slower to emerge for Brisbane, but now well in force.

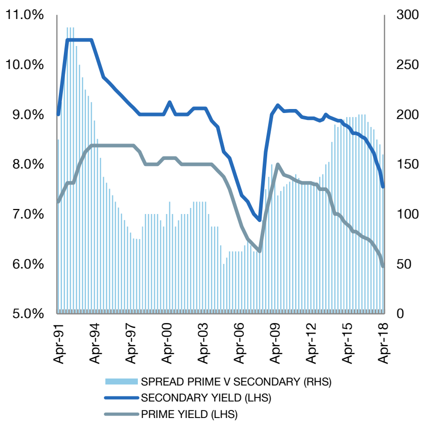
Over the past six months the median prime yield has tightened to below the levels recorded in 2007. In comparison, Sydney and Melbourne yields overtook the previous peak levels some 12 months earlier. However, Brisbane CBD secondary yields remain higher than 2007 levels, with leasing risk remaining a factor. Despite this, over the past year, the demand for value-add opportunities and competition for assets $100-150 million has seen yields firm faster, but from a higher base, for the secondary market than the prime.

The Brisbane secondary market yields are currently 6.60% - 8.50% with wide spread between assets which have received refurbishment and active leasing programmes and those yet to see such investment. On a median basis this reflects a 70bps reduction over the 12 months to April 2018. This tightening has occurred both at the lower and upper yield ranges as investors starved for product are taking strong positions on stabilised high B grade assets and at the same time the appetite for risk in an improving leasing market has also increased.

FIGURE 6

Brisbane CBD Core Market Yields

% Yield LHS & Basis Point Spread RHS

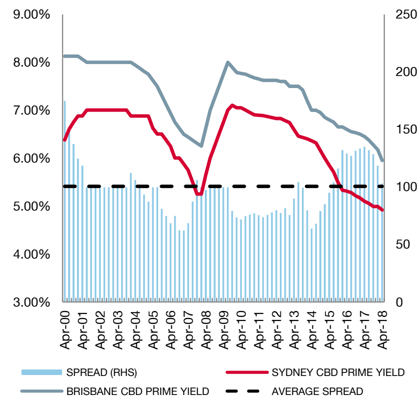


Source: Knight Frank Research

FIGURE 7

Brisbane CBD & Sydney CBD Yields

% Yield LHS & Basis Point Spread RHS



Source: Knight Frank Research

Outlook

- Over the remainder of 2018 it is expected that the fortunes of a number of proposed supply additions to the CBD will be crystallised. The largest of which is the potential for a new building to house Suncorp.
- Tenant demand has increased with the CBD likely to continue to benefit from users new to the market boosting the net absorption. While some major tenant decisions are taking longer than expected to reach fruition—ie Suncorp, Westpac, Technology One, ATO there are strong signs that the 1,000—5,000sqm tenants are increasing their propensity to relocate.
- The secondary market remains one of mixed fortunes as, despite the ever-increasing choice in smaller speculative fitted out space, the use of spec suites in tandem with overall building enhancement remains essential to create tenant activity within a secondary asset.
- Effective rents will continue to show appreciation through both face rental growth and a gradual erosion of incentives during 2018 with no new supply to cloud the market.
- In the absence of supply the vacancy rate will trend down over 2018 to sub-13.5%, before reacting to the completion of 300 George St and stabilising during 2019. Longer term, the significant supply expected in 2021-2022 will impact on total vacancy, although it is expected that the prime vacancy will continue to outperform the secondary.
- Yields have shown further substantial tightening during the past year and the gap between Brisbane and Sydney prime yields has returned to the long term average. With many major offshore investors still lacking a presence in Brisbane, further yield decreases are expected at, or above, the pace of change within the southern markets.
- Despite the US increasing cash rates and the likelihood of a similar UK move in the near future, long term bond rates have remained below the 3.0% psychological barrier to date. Nevertheless the expectation remains for cost of funds to increase gradually with focus to shift from yield compression to income maximisation.

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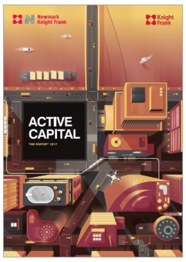

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