RESEARCH

# BRISBANE CBD

## OFFICE MARKET OVERVIEW MARCH 2020

## RECORD INVESTMENT DURING 2019

## HIGHLIGHTS

Positive net absorption continued throughout 2019 however new supply saw the vacancy rate increase to 12.7%. Leasing market activity is expected to slow as the impact of COVID-19 flows through.

Rental growth was driven by face rent with 2.8% prime and 3.0% secondary uplift in 2019. The current activity and confidence hiatus is likely to see incentives grow in the short term to engender activity.

Investment volumes reached record levels in 2019 at $2.65 billion, domestic buyers were resurgent with 61% of activity. The current travel restrictions and global uncertainty will slow transactions during H1 2020.

## KEY FINDINGS

Total vacancy increased to **12.7% in January 2020** with the positive net absorption outweighed by a major supply addition.

**Prime and secondary effective rents grew** by **2.8% and 5.0% y-o-y** respectively to January 2020. While **face rental growth** is strong, prime incentives have stalled.

New **supply in 2020** will be limited to the **7,200sqm** 12 Creek St annex building. Buildings currently under construction will add a further **104,000sqm in 2021/2022.**

2019 was a record year for total investment market turnover in the **Brisbane CBD at $2.65 billion**

Yields **tightened a further 20bps over 2019**. The current global uncertainty will impact on yields in the short term however co-ordinated central bank activities to **keep long term interest rates low provides structural support for yields**.


JENNELLE WILSON

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# ECONOMIC OVERVIEW

Improving tenant demand is set to be derailed by the evolving COVID-19 global lockdown during 2020. The length of the containment measures and speed of a return to business as usual will determine the impact.

## Growth outlook downgraded due to COVID-19

The evolving coronavirus outbreak clearly poses significant downside risks for the global and Australian economy. The spread of the virus globally is weighing on economic activity although the severity and duration of the impact remains highly uncertain.

Consistent with the deterioration in the global outlook, growth in the Australian economy will slow and most likely be negative this year. Reflecting the high degree of uncertainty around the outlook, economists' forecasts for 2020 GDP growth vary widely and have moved significantly in recent weeks. An average of 23 market economists shows a 3.9% fall in GDP for 2020, a significant revision from the 2.3% growth forecast at the start of 2020.

In Australia, the initial growth impact is being felt primarily through services exports such as tourism and education due to travel restrictions. The retail sector, initially food and beverage outlets, are being impacted by lower tourist numbers and social distancing measures adopted by the community, reducing discretionary spending. A further lockdown to preclude any non-essential movement or spending will further impact a wide range of businesses.

While the impact on office-based employment is likely to be more limited and take time to flow through the market, occupier demand may slow in the near term because of the spill-over effects from a weaker economic climate. Tenant mobility is likely to be negatively impacted in the short term.

## Strong policy response to drive recovery when the spread is contained

In response to the weaker growth outlook, the RBA has twice announced 25 basis points cuts to the cash rate target in March, now down to 0.25% which is expected to be the floor to official cuts. The RBA is also undertaking targeted measures to reduce bond yields and assist with local bank liquidity to support business lending during the virus spread.

Other central banks globally are taking similar measures to support growth and ensure widespread liquidity. In addition, the Federal Government has announced two stimulus packages equivalent to around 3.5% of GDP aimed at supporting households in the short term to minimise collateral damage and boosting business investment and consumer spending during the recovery phase. There is also growing expectation of a significant wages support package to keep workers aligned to businesses during this time of "hibernation". The record high level of government infrastructure spending will also continue to support growth.

TABLE 1

**Brisbane CBD Office Market Indicators as at January 2020**

| 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 | 1,273,134 | 10.9 | 35,213 | 47,700 | 781 | 35.0 | 4.90—5.95 |
| Secondary | 987,146 | 15.1 | -2,685 | -14,437 | 618 | 37.5 | 5.85—7.00 |
| **Total** | **2,260,280** | **12.7** | **32,528** | **33,263** | | | |

Source: Knight Frank Research/PCA *assumed WALE 4-6 years prime, 2-5 years secondary

# TENANT DEMAND & ABSORPTION

## Brisbane is not overexposed to vulnerable industries

The expansion of COVID-19 is expected to result in a hiatus of activity as companies defer major decisions such as relocations. Therefore, there is expected to be lower leasing activity through the middle of 2020. The duration of this market uncertainly remains unknown.

Longer term, as business operating conditions return to normal, the level of demand will be supported by the global and local monetary policy response and by fiscal stimulus already announced by the State and Federal Governments.

With the potential for extended restrictions on international travel the most exposed industries appear to be tourism and education. Despite Queensland being known as a tourist destination, as shown in Figure 1, the combined exposure to export tourism and education on gross state product is lower for Queensland than Victoria, New South Wales and Tasmania.

There has recently been a return to expansionary activity within the resources sector with BHP growing by 7,500sqm. A sustained global downturn may curtail this return to expansion, however we expect that the global expansionary fiscal policy of infrastructure and other capital investments will be supportive of commodity demand in the medium term.

**Net Absorption & Outlook**

| | |
|---|---|
| **Prime** | CY19: 35,213sqm |
| **Secondary** | CY19: -2,685 sqm |

Source: Knight Frank Research/PCA (adjusted to counteract the anomaly created by regrading

## Net absorption has been growing but downside risks are multiplying

With two consecutive calendar years of positive net absorption totalling 79,500sqm achieved, the Brisbane CBD market had been settling back into a more standard, organic growth-based pattern of demand. With fewer supply completions in either the CBD or the Fringe market there had been fewer large tenants crossing market borders and skewing net absorption results.

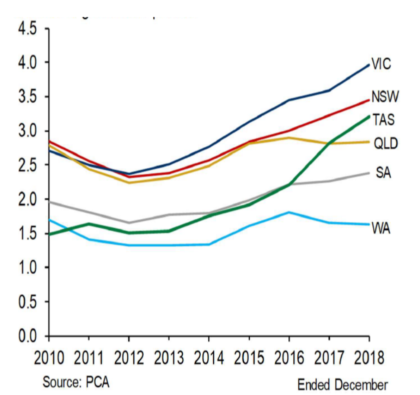
The prime market has continued to be the focus for net absorption with 30,289sqm in H2 2019 alone. Much of the prime improvement was due to activity in the premium market which saw strong net absorption of 23,581sqm in H2 2019. This has seen premium vacancy fall from 8.7% in July 19 down to an eight-year low of 3.2%. Take-up of premium space was dominated by Westpac's 6,643sqm relocation and Wework's new 6,000sqm facility in 123 Eagle St.

While A grade recorded good absorption of 11,809sqm in H2 2019 the addition of 300 George St (47,700sqm) was an outweighing factor, taking A grade vacancy to 13.7%. With premium vacancy now largely absorbed, there will be higher rental expectations for premium assets, drawing more tenants back to focus on A grade properties during 2020.

The secondary market net absorption disappointed in H2 2019 at –6,708sqm, negative for the first time in two years. However this result does mask a general market improvement as the relocation of Westpac from a B grade building of c12,000sqm was the defining factor taking net absorption negative.

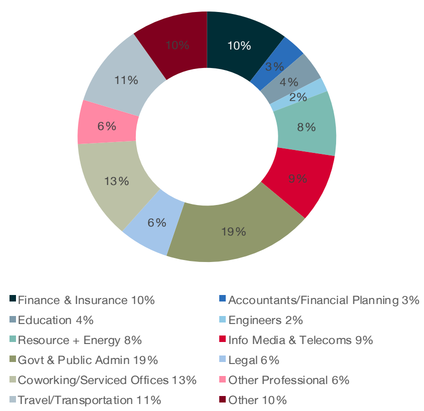
There will be significant impacts on tenant demand and net absorption from the unfolding COVID-19 situation. Net absorption forecasts based on the early March white collar employment outlook show a downturn with a relatively quick bounce-back. However, as the situation extends or business failures increase then downside risks increase as companies may downsize and/or the sub-lease market returns.

FIGURE 1
**Tourism & education service export**
% share of gross state product



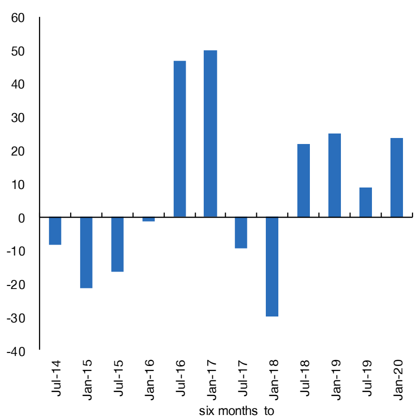

Source: Knight Frank Research/PCA

FIGURE 2
**Tenant activity by industry**
2019 by NLA taken (inc future moves)




Source: Knight Frank Research (relocations only)

FIGURE 3
**Brisbane CBD Net Absorption**
('000sqm) per 6 month period




Source: Knight Frank Research/PCA

# SUPPLY & DEVELOPMENT

## Past six months sees first new supply in three years

After a break in new building completions since late 2016 (1 William St) Q4 2019 and Q1 2020 saw the completion of additional newly constructed space.

The completion of 300 George Street in October 2019 added 47,700sqm of A grade stock into the Brisbane CBD. The building was completed with leases in place from two tenants—Urbis (2,250sqm) and Transurban (3,351sqm) which together saw the building 12% committed as at its opening. A long-mooted interest by the State Government to take 20,000-25,000sqm has not come to fruition. However, as is often the case, once a building is completed, tenant interest is intensified with Amazon recently leasing c4,100sqm of space, taking the building commitment to 20%.

The boutique annex building at 12 Creek St will complete March/April 2020. There are commitments in place to half of the floors on offer in the building. Tenants include McConaghy Property, Hudson Australia and Victory Serviced Offices.

Net supply for the CBD was positive in the six months to January 2020 for the first time in three years with the return of newly completed space combined with limited stock withdrawals.

## Low yields enhanced the feasibility of new supply

Aside from the 12 Creek St annex there are no further new completions during 2020. The 45,000sqm Midtown Centre redevelopment will be completed in H1 2021. Construction is well underway with the new façade being fitted to the development which is a combination of the two formerly-separate towers, now joined by lettable space, plus an additional eight floors constructed above the existing structures. The project is 44% pre-committed to Rio Tinto.

Due for completion during 2022, the premium development at 80 Ann St is well underway. The 60,243sqm building is 66% pre-committed to Suncorp with a flex office space to also operate from c10,000sqm of the building.

The sustained low yield and low cost of funds environment has resulted in a reduction to the economic rent threshold for potential new developments. Coupled with the high demand from both offshore and domestic investors to place funds into Brisbane this had resulted in an increase to the number of development schemes being actively pursued, the latest being GPT's proposal to build above the existing Pig n Whistle pub.

**Vacancy Rate**

| | |
|---|---|
| **Prime** | 10.9%<br>+90bps y-o-y |
| **Secondary** | 15.1%<br>-160bps y-o-y |

Source: Knight Frank Research/PCA

## Vacancy ticked up as new supply came online

Following sustained improvement to the vacancy rate through 2018 and 2019, the recent supply addition has outweighed the absorption of space, taking the total vacancy to 12.7% as at January 2020, up from 11.9% in mid-2019. This lift in vacancy was expected with net additions of 48,680sqm in H2 2019 always anticipated to have vacancy impact.

The trend of tenants upgrading had seen the prime vacancy improve, currently at 10.9%, with the secondary market still lagging. With the very real potential for tenants seeking cheaper rental options in the short term, there may be a greater shift towards secondary space.

Prior to the acceleration of the COVID-19 impact, forecasts continued to show an overall trend downwards in vacancy with short term increases as supply was added. This was anticipated to see the vacancy remain in the band of 11.0% to 12.3% over the next three years.

TABLE 2

**Brisbane CBD—Vacancy Rates**

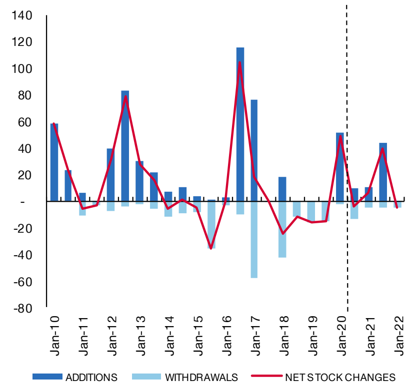
| Precinct | Jul 19 | Jan 20 |
|---|---|---|
| Premium | 8.7% | 3.2% |
| A Grade | 10.4% | 13.7% |
| **Prime** | **9.9%** | **10.9%** |
| B Grade | 14.1% | 14.3% |
| C Grade | 14.9% | 16.6% |
| D Grade | 15.1% | 21.0% |
| **Secondary** | **14.3%** | **15.1%** |
| **Totals** | **11.9%** | **12.7%** |

Source: Knight Frank Research/PCA

FIGURE 4

**Brisbane CBD Net Additions**

'000sqm additions, withdrawals and net supply

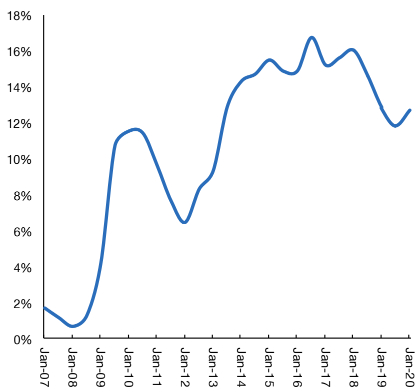



Source: Knight Frank Research/PCA

FIGURE 5

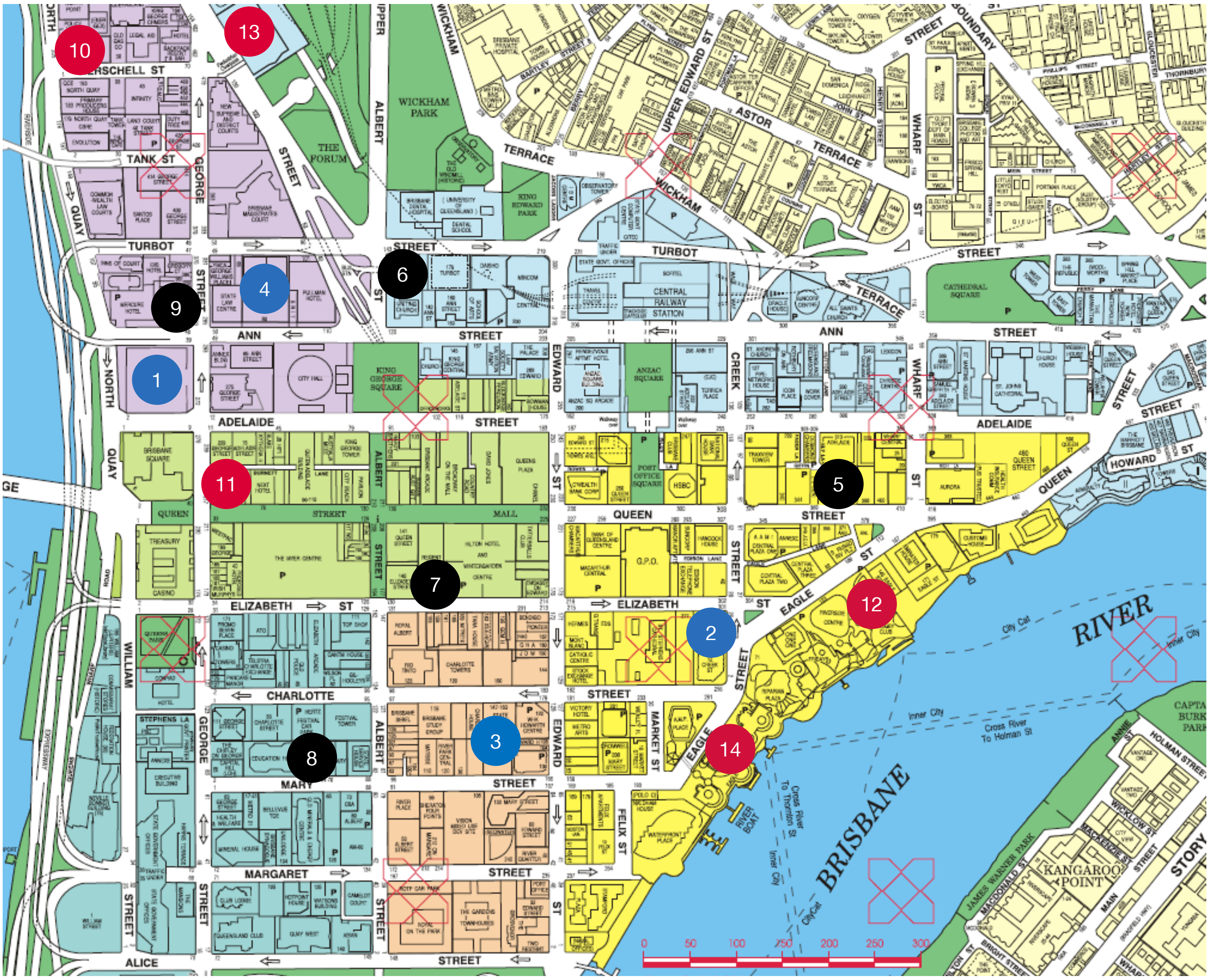
**Brisbane CBD Vacancy**

% total vacancy




Source: Knight Frank Research/PCA

# MAJOR OFFICE SUPPLY




| | |
|---|---|
| 1 | 300 George St—47,700sqm<br>Shayher Group—Completed Q4 2019 - 20% committed |
| 2 | 20 Creek St— 7,200sqm<br>Dexus Property Group/DWPF—Completed—Q1 2020—50% committed |
| 3 | #Midtown Centre 155 Charlotte St & 150 Mary St^—45,000sqm [Rio Tinto]<br>Ashe Morgan/DMC Projects—Construction—Mid 2021— 44% pre-committed |
| 4 | 80 Ann St—60,243sqm [Suncorp]<br>Mirvac/M&G—Site Works—H1 2022<br>66% pre-committed |
| 5 | 360-380 Queen St—c38,000sqm<br>Charter Hall POF & ICPF—STC<br>Development Approval |
| 6 | 143 Turbot St/343 Albert St—50,160sqm<br>CHC (5%)/GIC (95%)—STC<br>Development Approval |
| 7 | 150 Elizabeth St—c42,000sqm+<br>ISPT—STC<br>Likely to refresh design of existing DA |
| 8 | 62 Mary St—38,000sqm<br>QIC—STC<br>Development Approval |
| 9 | 320 George St—9,100sqm<br>Lionmar Holdings—tbc<br>Development Approval |
| 10 | 205 North Quay—55,000—60,000sqm<br>Cbus/Nielson Properties<br>Mooted—STC |
| 11 | No 1 Brisbane Site,<br>George & Queen Sts—c.35,000sqm<br>Site for sale—Mooted |
| 12 | 141 Eagle St—c27,000sqm<br>GPT—tbc<br>Mooted |
| 13 | Roma Street Transit Centre Airspace<br>c50,0000—70,000sqm<br>Mooted 2025+ |
| 14 | Waterfront Precinct - Office component c130,000sqm<br>Dexus Property Group—2026+<br>Masterplanning/ Market Led Proposal |

Complete / Under Construction or Site Works / Pre-committed

DA Approved

Development Application/ Mooted / Early Feasibility

Source of Map: Knight Frank
As at March 2020, excluding strata
#major refurbishment
^formerly known as Health & Forestry House
Avail office NLA quoted.
Major Pre-commit in [brackets] next to the NLA.
STC = Timing subject to tenant commitment

# RENTS & RECENT TRANSACTIONS

### Rents & Incentives

| | |
|---|---|
| **Prime Rents (g)** | $781/sqm face<br>2.8% y-o-y<br>$508/sqm eff<br>2.8% y-o-y |
| **Secondary Rents (g)** | $618/sqm face<br>3.0% y-o-y<br>$386/sqm eff<br>5.2% y-o-y |
| **Incentives** | P:35.0%<br>S:37.5% |

Steady demand and reducing vacancy pushed rents higher during 2019. For the prime market face rental growth was easier to obtain than incentive reduction, given tenants preferences for their moving costs to be underwritten. The secondary market has continued to show good improvement.

## Premium rents positioned to outperform in the short term

The premium market is expected to outperform A grade in terms of rental growth in the near term, given the reduced vacancy in this space and no imminent supply. Since 2017 the average gap between premium and A grade rents has been 15%-20%, far lower than the long term average of 26%. In the past six months the spread has turned, up from 16% in mid-19 to the current 18%. This trend is expected to continue as premium space no longer needs to discount to compete with A grade space, given the supply induced increase to premium vacancy (both direct and sub-lease) from the 2017 completion of 480 Queen Street has now been fully worked-though.

In contrast, the A grade market, while still achieving solid face rental growth, has seen some resistance to further incentive reductions. With tenants' likelihood of relocating premises linked to achieving the move with little to no capital outlay, particularly given the likely short term economic conservatism, incentives have the potential to soften in the short term as a necessary inducement to get tenants to make business decisions.

Secondary rents have continued to show good growth as the market recovers from the excessive vacancy, now at a more reasonable 15%. The rate of rental growth is expected to slow during 2020 as the implications of lower economic activity can have a greater impact on smaller businesses.

TABLE 3

### Recent Leasing Activity Brisbane CBD

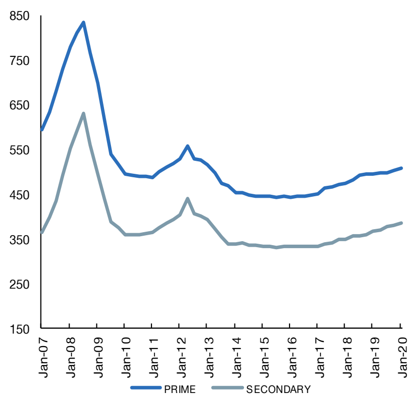
| Address | NLA m² | Face Rent $/m² | Term yrs | Incentive (%)` | Tenant | Start Date |
|---|---|---|---|---|---|---|
| 260 Queen St | 5,000 | 760 g | 12 | 30-35 | WeWork | Dec 20 |
| 12 Creek St annex | 1,875 | 820 g | 9 | 25-30 | Victory Serviced Offices | Aug 20 |
| 111 Eagle St | 1,499 | 950 g | 5 | 35+ | Next DC | Jun 20 |
| 275 George St | 2,602 | 795 g | 10 | Conf | Victory Serviced Offices | May 20 |
| 175 Eagle St | 2,204 | 776 g | 10 | Conf | New Hope Group | Apr 20 |
| 71 Eagle St | 3,729 | 880 g | 10 | 35+ | IWG | Feb 20 |
| 32 Turbot St | 1,686 | 770 g | 10 | 35+ | ACCC | Jan 20 |
| 345 Queen St | 1,529 | 775 g | 7 | 35+ | Coronado Curragh | Dec 19 |

`estimated incentive calculated on a straight line basis g gross

FIGURE 6

### Brisbane CBD Rents

$/m² p.a average gross effective rent




Source: Knight Frank Research

TABLE 4

### Recent Sales Activity Brisbane CBD

| Address | Grade | Price $ mil | Core Market Yield % | NLA m² | $/m² NLA | WALE yrs | Vendor | Purchaser | Sale Date |
|---|---|---|---|---|---|---|---|---|---|
| 66 Eagle St | A | 380.00 | 5.42 | 31,896 | 11,914 | 3.9 | APPF Commercial/ ADIA | Deka-ImmobilienGlobal | Mar 20 |
| 313 Adelaide St | B | 137.60 | 5.70 | 14,592 | 9,430 | 5.5 | Deutsche Asset Mgt | Prime Super | Dec 19 |
| 140 Elizabeth St & 141 Queen St | A/B | 395.00 | 5.93 | 31,708 | 12,457 | 3.5 | QIC | Shayher Group | Oct 19 |
| 140 Creek St, 295 Ann St & 232 Adelaide St | A/B | 425.00 | 6.0-6.50 | 52,537 | 8,122 | 3.9 | Oxford Properties | Ashe Morgan | Oct 19 |
| 400 George St | A | 524.75 | 5.30 | 43,624 | 12,029 | 5.4 | Blackstone/HSBC | Cromwell Property Gp | Aug 19 |

Source: Knight Frank Research #price net of incentives *weighted average.

# INVESTMENT ACTIVITY & YIELDS

## Record turnover in 2019 but likely lower in 2020

Investment activity reached a record high in 2019 with $2.65 billion transacted within the Brisbane CBD. This was only slightly higher than the prior year at $2.41 billion in transactions. Together 2018 and 2019 with $5.1 billion of turnover represented a watershed period for the Brisbane CBD market. The weight of money seeking investment, greater knowledge and acceptance of non-gateway cities as investment destinations and the steady improvement in tenant conditions all combined to see Brisbane firmly on the radar of offshore investors.

However, 2019 saw a noticeable decline in the level of transactions being undertaken by offshore buyers. Whereas offshore buyers dominated in 2018 with 73% of the turnover this reduced back to 39% in 2019. Overall there was no shortage of offshore investors keen to increase their exposure to Brisbane, however, two factors were slowing their pace of acquisition.

The first was the mid-2019 announcement by the Queensland Government of a foreign owner surcharge for land tax. Poorly implemented without warning the surcharge impacted certainty in the market. While the Government has since indicated an intended relaxation similar to the Victorian Scheme details remain limited. While offshore buyers were still actively pursuing Brisbane assets their pricing was slightly more modest. This opened the door for the second factor, which was well capitalised local buyers, frustrated at being recently out-bid by offshore buyers. These local buyers were now more competitive and successful in obtaining more assets.

**Current Yields & Outlook**

| | |
|---|---|
| **Prime** | 4.90% - 5.95%<br>-20bps y-o-y |
| **Secondary** | 5.85% - 7.00%<br>-20bps y-o-y |

Assumed WALE Prime: 4-6 yrs, Secondary 2-5 yrs

## COVID-19 to have an immediate impact on turnover levels

Transactions in early 2020 have been limited to the completion of the 66 Eagle St sale of $380 million to Deka and the $53.5 million sale of 410 Queen St to a Melbourne-based investor.

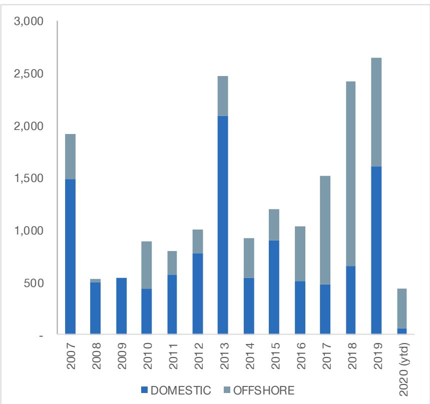
The emerging COVID-19 pandemic and associated travel and increasingly domestic movement restrictions is expected to limit activity in the short term. Launched campaigns such as 50 Ann St and 62 Queen St are likely to continue however it is expected that in the short term there will be few new campaigns launched. This will keep transactions low and provide limited price guidance in the short term.

## Central bank action to keep long term bond yields low

While not a financial crisis the cessation of activity due to COVID-19 has the potential to be a contagion in the financial markets. To combat this the central banks have globally responded quickly through monetary and unconventional policy to keep the short and long term base rates low. This will provide structural support to property yields, although the potential for confidence based softening remains as the length of disruption extends.

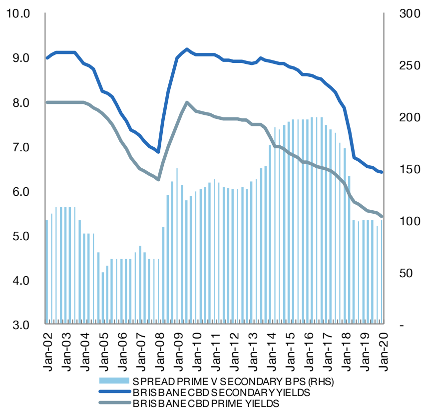
In the short term there is expected to be a softening of rental growth and occupancy assumptions which may impact pricing in the absence of a reset of yields. Vendors with the freedom to choose the timing of their sale are likely to delay until there is greater clarity in the market. The yield gap between Brisbane and Sydney is currently 105 bps but may slip above average levels in the short term as the market can price non-gateway cities differently in uncertain times.

FIGURE 7
**Brisbane CBD Transaction Activity**
$ millions transactions $10m+ & source of funds



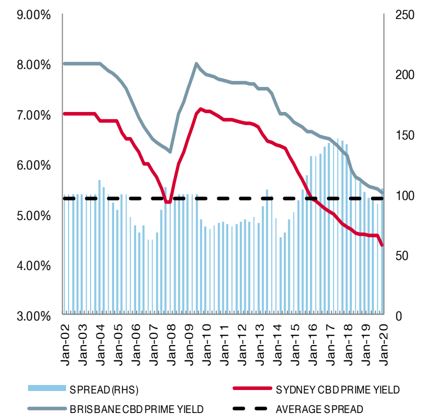

Source: Knight Frank Research

FIGURE 8
**Brisbane CBD Core Market Yield**
% Yield LHS & Basis Point Spread RHS




Source: Knight Frank Research

FIGURE 9
**Brisbane & Sydney Prime CBD Yield**
% Core Market Yield LHS & BPS Spread RHS




Source: Knight Frank Research

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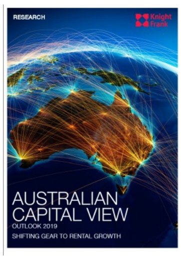


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