RESEARCH

Knight Frank

JUNE 2014

BRISBANE CBD OFFICE

Market Overview

HIGHLIGHTS

- The Brisbane CBD market faced very difficult leasing conditions during 2013, with strong contractionary influences dominating the market. While 2014 has seen improvement to tenant mobility and confidence, it will take some time for the market to post significant improvements to vacancy and rental levels.
- Market rents have continued to soften, although the rate of softening has slowed, with relatively stable conditions expected for the remainder of 2014. While face rents have been flat over the last 12 months, incentives have continued to build which has seen gross effective rents record falls of 9.1% for prime and 9.2% for secondary over the year to April 2014.
- The investment market, in contrast to the occupier market, has seen demand strengthen, particularly for prime assets. After recording a record level of total transactions of $2.467 billion during 2013, the market has begun 2014 with slightly diminished activity but building investment demand. Prime yields have firmed by 50 basis points over the past year to currently range 6.25% - 7.75% with most of the firming at the lower end of the yield range, for select assets. Due to the current leasing market challenges prime properties exposed to leasing risk have shown only limited yield firming to date.

BRISBANE CBD OFFICE

Market Overview

Table 1
Brisbane CBD Office Market Indicators as at April 2014

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	1,073,073	11.0	-14.885	17,354	676	33.0	6.25 – 7.75
Secondary	1,114,050	17.3	-83,882	-7,099	535	37.0	8.20 – 9.60
Total	**2,187,123**	**14.2**	**-98,767**	**10,255**			

Source: Knight Frank/PCA ^ as at January 2014

SUPPLY & DEVELOPMENT ACTIVITY

There was no new supply added to the Brisbane CBD market over the second half of 2013. The most recent new accommodation added to the market was the 18,517m² 55 Elizabeth Street development, which was completed in June 2013. The building was fully leased to the ATO, with that tenant relocating from two separate CBD locations.

In the short term, refurbished floors, either through partial or full building refurbishments, is expected to dominate supply in the market. Partial/staged refurbishment projects are currently underway at 280 Adelaide Street, 167 Eagle Street, 140 Creek Street, 175 Eagle Street, 145 Eagle Street, 10 Eagle Street, and 127 Creek Street. Refurbishment of either the building platform or individual floors is expected to become more important in attracting tenants, and owners who lack the capital to undertake these works will be at a disadvantage.

Given the relatively softer leasing conditions, particularly in the secondary market, aligned within an increasing demand from the residential and hotel accommodation market, the withdrawal of stock for conversion to another use has begun. The 9,469m², 80 Albert Street has been withdrawn from the market for a change of use to a hotel. Further potential withdrawals or conversions can be expected over the coming 18 months as heat builds in the residential market. At this stage there are two office buildings with vacant possession which are being marketed as residential development sites.

In addition, there are development sites which have converted from commercial proposals to residential over the past six months. To date the major examples are 30 Albert Street and 550 Queen Street and this demand is expected to continue to build.

There are currently three major CBD buildings under construction covering a total of 187,889m², however the first of these will not be completed until the latter half of 2015.

The first project to be completed is 180 Brisbane, at 180 Ann Street which is a 57,465m² tower. The project is being developed by the privately owned Daisho Group and completion is expected in Q4 2015.

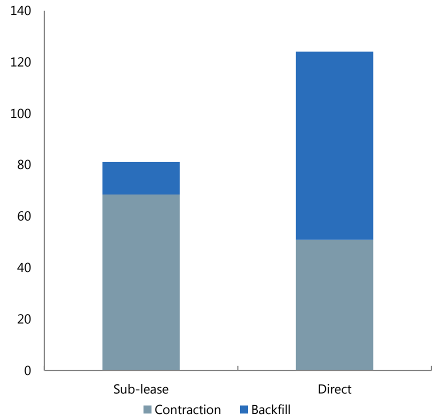
At 480 Queen Street construction is also underway on the 55,571m² tower which is expected to be completed in the first half of 2016. The project is 49% committed with the major tenants BHP (16,500m² - after taking an extra floor to their original tranche), Allens Linklaters (4,000m²) and Herbert Smith Freehills with 5,000m².

The other major completion for 2016 is expected to be the 74,853m² 1 William Street, which is also under construction. The State Government has fully committed to the office space in the building, however are offering 15,000m² of low-rise space in the building to the market as sub-lease. With the project now owned 50% by Cbus and 50% by ISPT the lead developer will continue to be Cbus.

Backfill & Contraction Space

Knight Frank has been tracking the amount of significant backfill and contraction space which has come to the market in Brisbane since 2012. The total uncommitted space being tracked has grown to 205,257m² as the total vacancy across the CBD has grown.

Figure 1
Brisbane CBD Backfill & Contraction
('000m²) available 2012-2014



Source: Knight Frank

Sub-lease space accounts for 81,162m²of this total and there are signs that this number has peaked for the short term. During the first few months of 2014 just under 12,000m² of sub-lease space has been committed by tenants such as Suncorp, Commonwealth Fair Work Ombudsman and Runge. In addition some previously marketed space has been removed from the market. While these deals are being undertaken at a discount to the wider market rates, this is an encouraging sign.

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MAJOR OFFICE SUPPLY

1 — 111 Eagle St – 64,041m²
[ANZ/E&Y/Arrow] GPT– June 2012 – 94% committed

2 — 55 Elizabeth St -18,517m² [ATO]
Grocon/Credit Suisse – June 2013 – 100% committed

3 — #126 Margaret St – 5,718m²
Investec Prop Opportunity Fund Q1 2013

4 — #420 George St – 6,500m²
Nielson Properties – Q2 2013

5 — ^295 Ann St – 9,600m².
Investa Office Fund *Qld Rail* Q1 2013

6 — #363 Adelaide St – 14,962m²
Investa Property Group (for sale). Q3 2014

7 — 180 Ann St – 57,465m²
Daisho – Q4 2015

8 — 480 Queen St – 55,571m² - [BHP/Freehills]
Grocon (DEXUS/DWPF) –Q2 2016 – 49% committed.

9 — 1 William St, 74,853m² [State Govt]
Cbus Property/ISPT – Q4 2016 – 100% committed (^15,000m² for sub-lease)

10 — 111 Mary St– 35,000m²
Billbergia/ AMP Capital – 2016+

11 — 30 Albert St – 24,838m²
Cornerstone Properties – likely residential

12 — 550 Queen St – 18,539m² GFA
Consolidated Properties (for sale) – likely residential

13 — The Regent Development – 50,000m²
ISPT – tba - potential residential/hotel

14 — Transit Centre Stage II – 70,000m²
GPT/APPF – tba

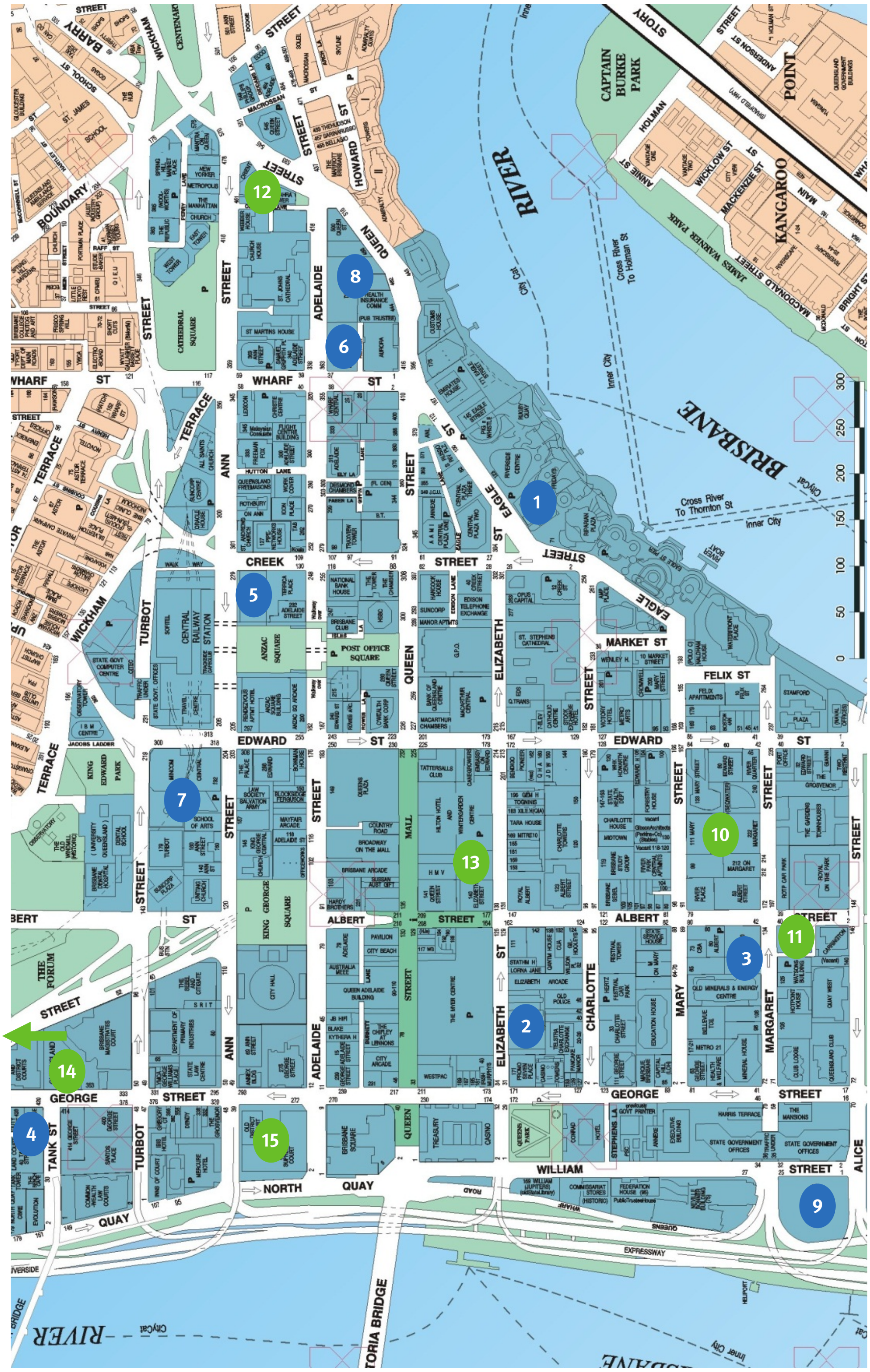
15 — 300 George St – 46,162m² (office bld)
Shayer Group - tba

Under Construction / Complete

DA Approved / Confirmed / Site Works

Mooted / Early Feasibility

As at May 2014, excluding strata buildings.
Major Refurbishment / entire building available
^ Sub-lease space >5,000m² contiguous.
Sub-Lessor indicated in *italics.* Avail Office NLA Quoted. Major pre-commits in [brackets] next to NLA. Source of Map: Knight Frank



TENANT DEMAND & RENTS

Soft tenant demand across the second half of 2013 saw the official vacancy rate increase to 14.2% as at January 2014, up from the 9.3% recorded a year earlier. The prime market vacancy increased to 11.0% and apart from a short period in 2009 when several new buildings were delivered, this is the first time since 1997 that the prime vacancy has been in double figures.

Table 2
Brisbane CBD – Vacancy Rates
Vacancy by building grade

Precinct	Jan 2013	Jan 2014
Premium	11.7%	12.8%
A Grade	7.3%	10.6%
Prime	**8.1%**	**11.0%**
B Grade	10.1%	18.7%
C Grade	8.9%	12.6%
D Grade	19.4%	16.1%
Secondary	**10.0%**	**17.3%**
Total	**9.3%**	**14.2%**

Source: PCA

Conditions in the secondary market have continued to soften, with the total vacancy increasing to 17.3%. For the secondary market the greatest impact was during the first half of 2013 when the vacancy increased to 16.1% as at July 2013, with the second half of 2013 not as dramatic. This was largely due to the State Government relinquishing space, which was largely secondary accommodation.

Net Absorption

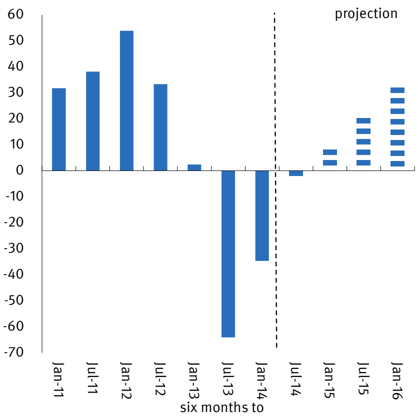
The Brisbane CBD market recorded negative net absorption of -98,767 over the calendar year of 2013 as the market was impacted by contraction (both private sector and from the State Government) and relocation of tenants to the Fringe market. With the Brisbane market only rarely recording significant back to back six month periods of negative net absorption, this result was the highest annual fall on record.

With much of the negative influences now in the past, the net absorption is expected to show recovery in the medium term. With some improving activity across the market balanced against continuing contraction and sub-lease activity, the net absorption for the first half of 2014 is expected to be marginally negative.

NET ABSORPTION TO IMPROVE FROM LATE 2014

Conditions are expected to continue to steadily improve from mid-2014 with net absorption returning to trend levels by late 2015. While some tenants are still favouring to move from the CBD to newly constructed fringe accommodation (ie Flight Centre 20,000m²) the relatively lower A and B grade rents are drawing some fringe and suburban tenants back to the CBD existing assets (ie On the House - 1,287m²).

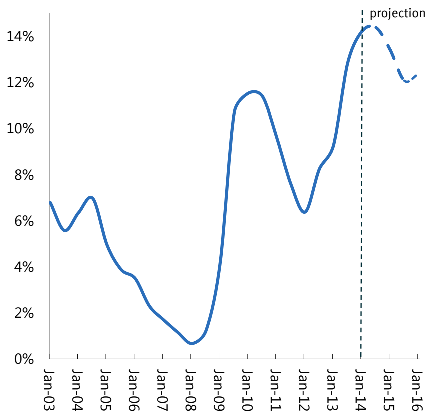
Figure 2
Brisbane CBD Net Absorption
('000m²) per 6 month period



Source: PCA/Knight Frank

Anticipated Vacancy Levels

Figure 3
Brisbane CBD Vacancy
% total vacancy



Source: PCA/Knight Frank

The vacancy rate is expected to remain in the range of 14 – 14.5% to the middle of 2014, before beginning to show some improvement through the second half of the year. The absence of any additional new construction and expected steady withdrawals of space is expected to support the vacancy rate steadily falling through to mid-2015, bottoming out at 11.8%. The addition of new supply through late 2015 and into 2016 is expected to reverse this trend, however at this stage the vacancy is expected to remain below 13.5% in 2016.

The reduction in the vacancy rate may be accelerated by additional withdrawals of stock for a change of use. Potential short to medium term withdrawals include 310 Ann Street (16,435m²), 363 Adelaide Street (14,968m²) and 240 Margaret Street (3,566m²). In late 2016/2017 the State Government will demolish 80 George Street (16,150m²), 100 George Street (22,906m²) and 75 William Street (18,600m²) for the Queens Wharf development. In addition the QIC owned 81 George Street (10,600m²) has been selected as the site of the proposed George Street BaT station.

Tenant Demand

Tenant demand was extremely soft during 2013 and the impact of that time will continue to have repercussions across the market in the medium term. However most of the negative influences appear to have now passed and since the start of 2014 the level of activity in the market has shown some improvement. There has been an increase in both tenant demand and mobility being observed, meaning that not only are enquiry levels building but there is a slightly increased willingness to take action within a reasonable timeframe. To date this has been most evident in the smaller end of the market (sub-500m²) but there is also an increase at the larger end of the market. A number of tenants with long-running, high profile requirements have recently, or are in the process of, finalising long term lease deals - in some cases many years before occupation or the expiry of their existing accommodation. Examples of this include Corrs Chambers Westgarth, Allens Lawyers, and Australian Financial Security Authority.

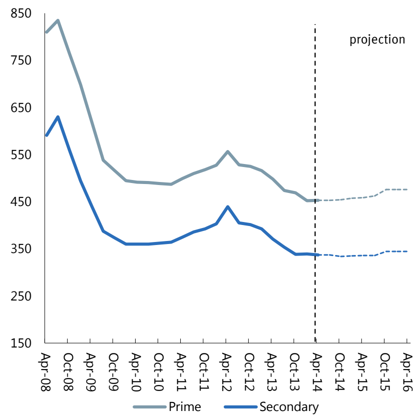
This increased activity and commitment for longer term occupancies, in addition to building confidence in the market, is also a manifestation of the general sentiment that rental levels are stabilising. The expectation is growing that major deals done now will represent the low point of the market.

Rental Levels

Rental rates have continued to soften over the past year, across both the prime and secondary markets. However there is now some indication of stabilisation, particularly for the prime market. Nevertheless the level of prime sub-lease space available has still led to leasing deals done at significant discounts to the general market rate. A recent example is the reported space leased by Suncorp in 123 Albert Street; the five floors (7,500m²) on a 7 year sub-lease from Rio Tinto have been taken at a reported effective rate of $325/m² gross. While much of the prime sub-lease space does offer shorter terms, it is still expected to see sub-lease deals done at levels considered out of line with the wider market.

Average gross face rents for prime space have settled at $676/m² as at April 2014, a fall of 1.6% over the past 12 months, with some push-back on face rents in evidence within select prime buildings. Incentives have continued to build, currently averaging 33% within prime accommodation, up from 27.5% a year ago. This has resulted in a fall to the average gross effective rent of 9.1% over the past year, to sit at $453/m². Effective rents are expected to remain largely stable for the remainder of 2014 with marginal improvement emerging late 2014/early2015, with 1.3% growth forecast to April 2015.

Figure 4
Brisbane CBD Rents
$/m² p.a average gross effective rent



Source: Knight Frank

Average gross secondary face rents are currently $535/m² which is largely unchanged from a year ago, as the secondary market struggles with record high vacancy levels. Incentives have continued to increase, currently averaging 37% for secondary accommodation – up from 30% a year ago. Overall the effective rent has softened a further 9.2% over the 12 months to April 2014 to average $337/m² gross. Going forward the secondary rents are expected to soften further slightly to the later part of 2014 and then plateau with little to no improvement expected prior to the second half of 2015.

Table 3
Recent Leasing Activity Brisbane CBD

Address	Grade	Area (sq m)	Face Rental ($/m²)	Term (yrs)	Incentive (%)`	Lease Type	Tenant	Start Date
480 Queen St	Premium	4,000	undis	8	undis	Pre-Lease	Allens Linklaters	Jun 16
123 Albert St	A	7,500	c350 g	7	Nil	Sub-Lease	Suncorp	June 15
111 Eagle St	Premium	6,000	undis	15	undis	New	Corrs Chambers Westgarth	Oct 14
400 George St	A	1,423	710 g	4.5	35+	Sub-Lease	Fair Work Ombudsman	Apr 14
145 Ann St	A	2,210	675 g	10	25-30	New	QBE	Mar 14
215 Adelaide St	A	927	575 g	5	30-35	Existing	Bendigo & Adelaide Bank	Jan 14
1 Eagle St	Premium	700	825 g	7	20-25	Existing	UBS	Dec 13
215 Adelaide St	A	2,411	575 g	10	undis	Existing	Barry.Nilsson Lawyers	Nov 13
444 Queen St	B	2,844	540 g	4	undis	Existing	TSA	Oct 13
443 Queen St	A	1,102	650 g	5	25-30	Existing	Cubic Transport	Oct 13
200 Adelaide St	B	1,287	555 g	6	35+	Existing	On the House	Oct 13

Source: Knight Frank g gross `estimated incentive calculated on a straight line basis

INVESTMENT ACTIVITY & YIELDS

The investment market has been on an upswing during 2013 and into 2014 with Brisbane sharing in the high demand for investments which is currently in evidence. Total transaction activity for 2013 was at record levels of $2.467 billion, well above the previous high in 2007 of $1.947 billion. This was boosted by three large transactions (State Govt Portfolio, 1 William St 50% pre-sale and 480 Queen St pre-sale) which accounted for $1.47 billion (60% of the total). However there was strong general transaction activity which emerged at the end of 2013.

To date in 2014 there has been $284 million in sales activity from two major transactions as despite continued high demand for prime product, there has been relatively fewer transactions when compared with Sydney and Melbourne. In part this is due to a lack of prime properties available for sale but also the residential conversion trend, which is active in the southern cities, has not yet spread to Brisbane's secondary market although it is expected to in due course.

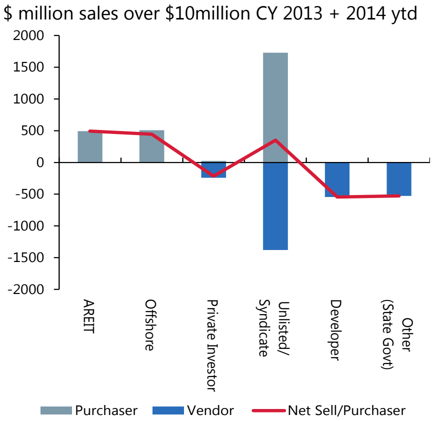
Demand for prime assets has continued to build, particularly those which are insulated from the current tenant market weakness. Following the lead of the southern markets there has been strong firming to the prime yield over the past six months. The recent sale of 70 Eagle Street has demonstrated this demand for prime assets, with the US based purchaser, Pembroke Real Estate, paying c$123 million for the 11,476m² asset which reflected a core market yield of 6.25%. This reflected an improved rate of $10,692/m² and along with 1 William Street are the first major commercial sales to breach the $10,000/m² barrier since 2007.

A 50% interest in 1 William Street was sold in late 2013 to ISPT. The building, in the initial phase of construction, is a 74,853m² tower with the office space fully pre-committed to the State Government on a 15 year term from completion in late 2016. The transaction involved a transfer of 50% of the site value and works to date with the remainder to be paid over the course of construction, however the majority is a balloon payment at the end of the development period. The deal is understood to reflect an end value in the order of $400 million for the half share, based on a capitalisation rate of 6.5%. Cbus will retain the other half of the asset and remain the lead developer of the project. The State Government is currently offering 15,000m² of their space on a sub-lease basis.

The other recent major sale was the DEXUS Wholesale Fund's purchase of 60 Albert Street for $161.3 million. With a shorter WALE and significant sub-lease space available within the building, despite its modern prime characteristics it was relatively harshly treated by the market, reflecting a core market yield of 8.16%.

During 2013 and 2014 ytd the market activity has been dominated by unlisted funds and syndicates, however AREITs and offshore investors have been the strongest net buyers of Brisbane assets, with no divestments.

Figure 5
Brisbane CBD Purchaser/Vendor
$ million sales over $10million CY 2013 + 2014 ytd



Source: Knight Frank

Table 4
Recent Sales Activity Brisbane CBD

Address	Grade	Price ($ mil)	Core Market Yield (%)	NLA (m²)	$/m² NLA	WALE	Vendor	Purchaser	Sale Date
70 Eagle St	A	c123.0	6.25	11,476	10,692	8.4	APPF Commercial Fund & ADIA	Pembroke Real Estate	Apr 14
60 Albert St	A	161.3	8.16	21,263	7,586	4.6	La Salle Investment Mgt	DEXUS Wholesale Property Fund	Jan 14
1 William St	A	400.0#	6.50#	76,853	10,409	15.0	Cbus Property	ISPT	Dec 13
82 Eagle St	B	23.6	8.18	4,552	5,418	3.3	Standard Life Inv.	Private Investor	Dec 13
307 Queen St	A/B	120.8	8.05	19,650	6,148	2.8	Westlawn Property Trust	GDI Property Group	Dec 13
179 Turbot St	A	172.3	8.13	24,975	6,899	5.7	Morris Property Group	Kumpulan Wang Persaraan (Investa)	Nov 13
157 Ann St	B	39.0	8.86	6,679	5,839	5.5	City of Brisbane Investment Corp	Astreo Property Ventures	Oct 13

Source: Knight Frank ADIA = Abu Dhabi Investment Authority
50% sale of the development with the reported yield on completion of 6.5%, vendor retains the other 50% share and remains the lead developer.

AREITs have continued to be acquisitive as their improved balance sheets have given them scope and there appears to be a current imperative in the market to grow. Major recent acquisitions for AREITs have included the 50% share in 480 Queen Street purchased by DEXUS Property Group and GDI Property Group's $120.8 million purchase of 307 Queen Street. Offshore capital has also continued to flow into the Brisbane market with Pembroke Real Estate the most recent new entrant to the market, purchasing 70 Eagle Street for c$123 million.

The firming trend, particularly for prime yields as a response to the increasing appetite from both local and international buyers is well evidenced by the firming seen to date with the 8.4 year WALE for 70 Eagle Street attracting a core market yield of 6.25%. This comes only four months after the 15 year WALE, 1 William Street sold reflecting a 6.5% yield, albeit for a far larger amount with deferred settlement. The imperative for immediately placing funds into prime assets is expected to continue.

Average prime yields are currently 6.25% - 7.75% with a median of 7.0%, which represents firming of 50 basis points over the past year. Much of this firming has come from reductions at the lower end of the yield range, with the upper range having moved relatively less reflecting the leasing risk embodied within the market at this time.

Secondary yields have firmed only marginally over the past six months as the leasing conditions remain soft. Secondary yields currently range between 8.20% and 9.6%, with a median of 8.9%. Although the interest in recycling CBD buildings is building, without the pressure from residential developers supporting prices as with the southern states, the yields for secondary assets are not under any major pressure at this time. There is expected to be a flow through of the firming trend from the improvements in the prime market over time, however this effect is being moderated by the relatively difficult leasing conditions in the secondary market.

OUTLOOK

Tenant demand has remained quite soft in the initial months of 2014, however there are positive signs emerging in the market. Improved enquiry levels are beginning to translate to greater activity with tenants more likely to relocate than in recent years. While this has been concentrated in the smaller (sub-500m²) tenants and the larger 5,000m²+ tenants there are some signs that this activity is broadening.

While there are likely to still be rental deals which surprise on the downside, particularly for sub-lease space or buildings which have relatively low occupancy, the consensus is that average market rents have little further to fall. Both prime and secondary effective rents are expected to drift further through to the third quarter of 2014, but thereafter begin a slow improving trajectory.

EFFECTIVE MARKET RENTS ARE AT OR NEAR THEIR NADIR

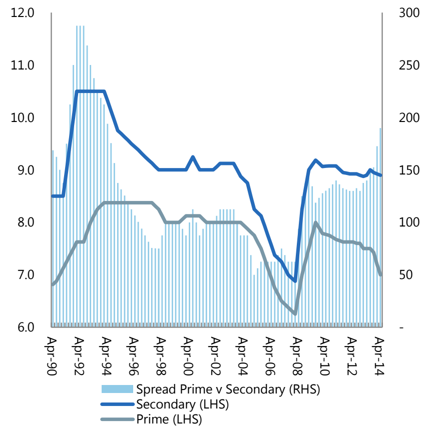
Net absorption is expected to gradually recover, after a flat result to mid-2014, taking a further 18 months to return to trend levels. With a return to net absorption, no new supply and the potential for further withdrawals of space, the vacancy rate is expected to show steady declines from late 2014 through to late 2015 when the next major supply is expected to come to the market (180 Ann Street).

Nevertheless, despite the expectation of improved conditions from the latter half of 2014, it will take some time for this increased activity to flow through to any substantial improvement in rental rates. Prime effective rents are expected to show 1.3% and 3.7% p.a growth for the next two years, lower for secondary at -0.3% and 2.7%.

Figure 6

Brisbane CBD Yields & Risk Spread

%yield (LHS) & spread prime v secondary bps (RHS)



Source: Knight Frank

The marked differential between the conditions in the leasing market and the capital transaction market are expected to remain in the short term. Investment demand is continuing to build and while most of the current demand is for prime assets, this is expected to spill over to the secondary market in due course. The demand for residential development sites has already converted a number of previously commercial sites to residential and it is only a matter of time before developers also consider improved buildings for conversion, given the extent to which this market segment is active in the southern cities. With the general Brisbane residential market some 9-12 months behind the southern states this demand will build.

In the short term, however, the risk premium between prime and secondary yields is expected to remain at historically high levels. The current risk premium, at 190 basis points, is the highest which has been seen since 1994 (see Figure 6) and is 50% above the long term average. With a secondary vacancy rate of 17.3% it could be argued that such a risk premium is warranted, however it is expected to narrow again in the medium term. Demand for prime investment stock, particularly where insulated from the leasing market in the coming 3-4 years, will continue to build with offshore and local investors competing to place funds.

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