RESEARCH

BRISBANE CBD

OFFICE MARKET OVERVIEW SEPTEMBER 2014

HIGHLIGHTS

Tenant activity is showing some signs of improvement however growth/expansion is fragile. A short lived supply cycle in 2015 & 2016 will deliver 180,000m² and trigger additional withdrawals of stock.

Effective rents have continued to soften with any improvement to face rents at the expense of higher incentives. Prime rents have now stabilised with likely improvement in early 2015 as vacancy peaks.

Strong investment demand has continued to place downward pressure on prime yields, particularly for assets which are protected from exposure to the current leasing conditions.

KEY FINDINGS

Sublease space caused by contraction or backfill, tracked by Knight Frank, **has fallen by 38% since February 2014**

Prime effective rents softened by 4.3% over the past year, but have now stabilised

Increasing tenant activity and upgrading is expected to **benefit the A grade market**

Prime yields firmed by 50bps over the past year, with further pressure at the lower yield range

JENNELLE WILSON
Director — Research QLD

SUPPLY & DEVELOPMENT

With major supply additions looming in 2015 & 2016 the current hiatus in supply is a welcome opportunity for the leasing market to stabilise. The level of sub-lease space is falling which is a positive first sign.

Net supply additions to the Brisbane CBD market were neutral at 861m² over the first half of 2014. With the return to the market of two partial refurbishments balanced by the withdrawal of 80 Albert Street (9,118m²) which is being converted into a hotel. Net additions in the second half of 2014 are expected to be negative with the withdrawal of 171 George Street (8,260m²) for conversion to a hotel. Withdrawals for change of use are expected to continue in the first half of 2015 before the next supply cycle adds 188,000m² of new stock to the market in less than 18 months.

180 Ann Street is expected to be completed in Q4 2015. The project, developed by the privately owned Daisho Group, is understood to be in advanced negotiations with a 12,000m² tenant. In 2016 the two major completions are 480 Queen Street which is 72% pre-committed and 1 William Street, which is fully committed by the Queensland Government. To balance this new supply, over the two and a half year period from mid-2015, approximately 125,000m² of stock is to be withdrawn from the market. In the main these buildings will be demolished for the Queens Wharf redevelopment and also for the creation of the BaT George Street Station and all house State Government workers.

Beyond projects under construction, most other significant office development proposals are being converted into residential or hotel schemes. With 30 Albert Street bought by an offshore residential developer and 111 Mary Street seeking an alternative hotel DA, this trend is expected to continue.

Sub-lease/Backfill

Sub-lease space appears to be close to its peak with the most recent analysis by Knight Frank of major backfill and contraction space showing the sub-lease component falling below 60,000m² for the first time since early 2013. The fall in sub-lease space, from 94,057m² in February 2014 to 58,158m² in August 2014 has arisen from three factors. Of the reduction approx. half converted to direct space, 30% was leased and a further 20% with withdrawn by the sub-lessor.

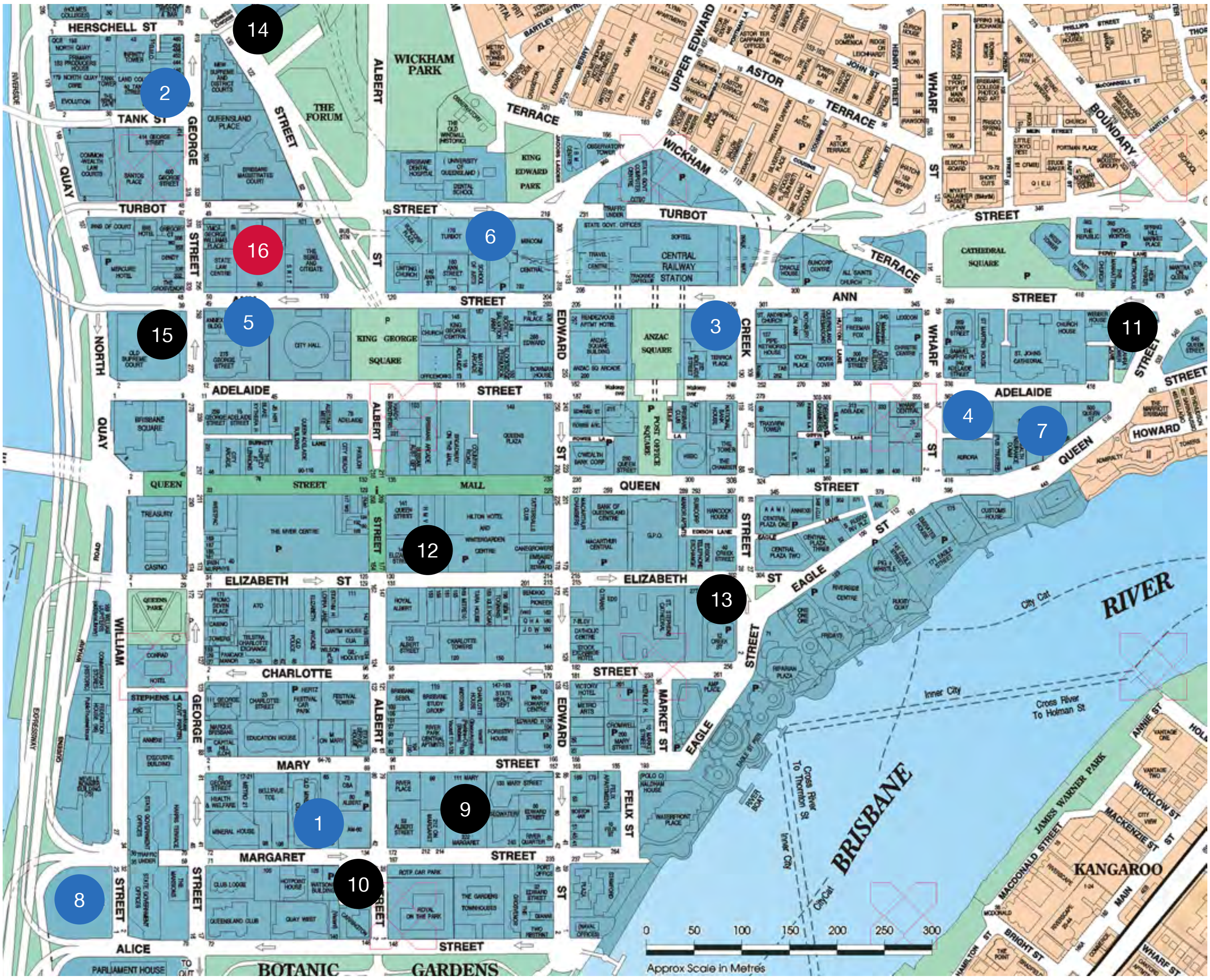
In contrast, the direct space made available via major contraction or backfill during 2012-2014 has remained relatively stable with only modest take-up to date. In the order of 83% of this space is within secondary accommodation and will take some time to be absorbed by the market. Apart from the backfill space arising from tenant relocations in 2014, a further tranche of backfill space is anticipated as a result of relocation to new construction in both the CBD and fringe. Over the course of 2015-2017, and excluding relocations by State Government, in the order of 60,000m² of backfill space has been identified to date, exclusively in prime accommodation.

TABLE 1
Brisbane CBD Office Market Indicators as at July 2014

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	1,073,073	11.0	-16,638	-	690	35	6.25—7.75
Secondary	1,114,911	18.2	-27,491	-4,675	537	37	8.15—9.60
Total	**2,187,984**	**14.7**	**-44,129**	**-4,675**			

Source: Knight Frank/PCA

MAJOR OFFICE SUPPLY



- **1** — #126 Margaret St—5,718m² Investec Prop Opportunity Fund Q1 2013—10% committed
- **2** — #420 George St—6,500m² Nielson Properties Q2 2013—14% committed
- **3** — ^295 Ann St—9,600m² Investa Office Fund *Qld Rail* Q1 2013
- **4** — #363 Adelaide St—14,962m² Investa Property Group (for Sale) Q3 2014
- **5** — ^69 Ann St—6,000m² Charter Hall CPOF *QLD Gas* Q3 2014
- **6** — 180 Ann St— 57,465m² Daisho Q4 2015
- **7** — 480 Queen St—55,571m² [BHP/ PwC/ Freehills] Grocon (DEXUS/DWPF) - Q2 2016—72% committed
- **8** — 1 William St—75,853m² [State Govt] Cbus Property/ISPT—Q4 2016 100% committed (15,000m² sub-lease)
- **9** — 111 Mary St—35,000m² Billbergia/AMP Capital (under contract) —likely hotel
- **10** — 30 Albert St—24,838m² Aspial Corporation - likely residential
- **11** — 550 Queen St—18,539m² GFA Consolidated Properties (JV Qualitas) likely residential
- **12** — The Regent Development—50,000m² ISPT—tba—potential residential/hotel
- **13** — 12 Creek St Annex—6,297m² GFA DEXUS Property Group/DWPF—tba
- **14** — Transit Centre Stage II—70,000m² GPT/APPF— potential residential
- **15** — 300 George St—46,162m² Shayer Group—tba
- **16** — Primary Industries Building Ann & Turbot Sts—QIC Funds

Under Construction / Complete

DA Approved / Confirmed / Site Works

Mooted / Early Feasibility

As at September 2014, excluding strata
#major refurbishment/entire building available
^sub-lease space >5,000m² contiguous
Sub-lessor identified in *italics*.
Avail office NLA Quoted.
Major Pre-commit in [brackets] next to the NLA.
Source of Map: Knight Frank

TENANT DEMAND & RENTS

Continued muted tenant demand across the first half of 2014 caused the official vacancy rate to increase to 14.7% as at July 2014, up from the 14.2% recorded in January. The prime market vacancy rate was 11%, stable from six months earlier, but up from 9.4% in July 2013. The A grade market has recently shown signs of improvement as tenants upgrading their accommodation began to have some influence on the market.

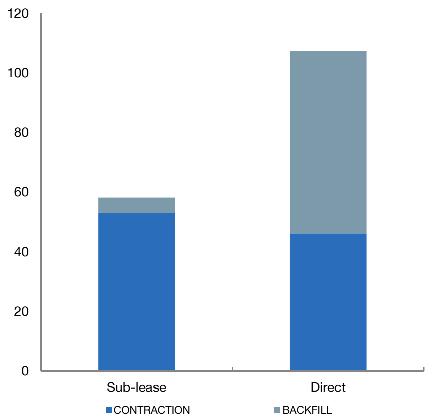
TABLE 2
Brisbane CBD—Vacancy Rates

Precinct	July 13	July 14
Premium	12.0%	14.2%
A Grade	8.8%	10.2%
Prime	**9.4%**	**11.0%**
B Grade	17.0%	20.1%
C Grade	12.2%	11.7%
D Grade	17.6%	16.8%
Secondary	**16.1%**	**18.2%**
Totals	**12.8%**	**14.7%**

Source: Knight Frank/PCA

In contrast the secondary market has continued to weaken, with the total vacancy increasing to 18.2% up from 16.1% in July 2013. B Grade, which accounts for the vast majority of secondary accommodation, and 38% of the total Brisbane market, has the highest vacancy at 20.7%.

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



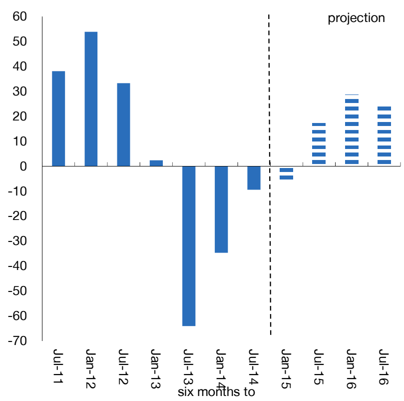
Source: Knight Frank

Net Absorption

The Brisbane CBD market recorded negative net absorption of –44,129m² over the 2013/14 financial year as the market was influenced by tenant contraction and relocation of tenants to the Fringe market. However with the net absorption for the CBD being –9,431m² in the first half of 2014, the quantum of contraction is falling.

There is improving leasing activity across the market, however this will be balanced against expected additional backfill vacancy in the second half of 2014 from tenants such as Bank of Queensland, Boeing and Ventyx. Therefore the net absorption is forecast to remain negative to the end of 2014, although this will blur the tentative beginnings of improved tenant activity.

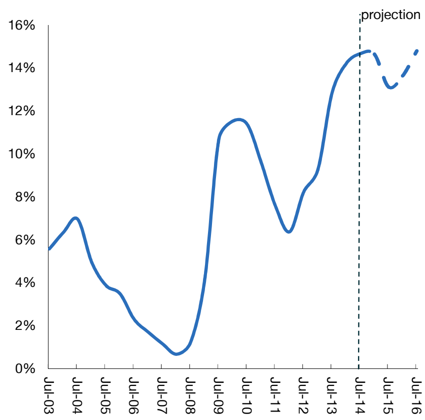
FIGURE 2
Brisbane CBD Net Absorption
('000m²) per 6 month period



Source: Knight Frank/PCA

Conditions are expected to steadily improve in 2015 with net absorption returning to historical trend levels by late 2015. Forecasts of back to back Qld GSP in excess of 4% p.a between 2015 and 2017 fuel this belief (Deloitte Access Economics). Reversing recent activity, the migration trend is expected to favour tenants returning to the CBD from other markets, due to the abundance of A and B grade accommodation and the competitive deals being offered to engender activity.

FIGURE 3
Brisbane CBD Vacancy
% total vacancy



Source: Knight Frank/PCA

Vacancy

The vacancy rate is expected to remain at similar levels to the current during the remainder of 2014 as negative net absorption will be largely balanced by net withdrawals of stock. There is expected to be improvement during 2015 as there is positive net absorption in a climate of low or negative net supply. However with the first of the major supply additions due in late 2015, this window to improve the vacancy rate is now narrowing.

Once the major new supply additions during 2015 & 2016 come to the market the vacancy is expected to increase once more, peaking back in the high 14%s, very close to current levels, in mid to late 2016. Beyond that, the limited proposals remaining for office construction are expected to facilitate another hiatus in commercial construction through to 2018+. This lower supply addition cycle is potentially to occur within a period of higher net absorption and the vacancy is expected to show good recovery.

In 2017, the withdrawal of stock, largely the State Government buildings, will be beneficial for the total vacancy rate. In the intervening time, the announced and potential withdrawals of secondary buildings for residential or hotel conversion will have a positive but modest impact on the vacancy rate.

Tenant Demand

The majority of the negative influences of 2012 & 2013 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 improvement 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, HWL Ebsworth, AFSA and Uniting Care.

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. The level of prime sub-lease space has fallen to 25,500m² and despite the discounts being achieved for this space (ie Suncorp taking 7,500m² at c$350 gross effective), the absorption of this space, particularly those with longer lease terms remaining, boosts stability within the market.

The push back on prime face rents has continued to build over the course of 2014, however owners have been required to surrender further to incentives. Average gross face rents for prime space are at $690/m² as at July 2014, basically stable from a year ago, but an increase from the start of 2014. Incentives have continued to build, currently averaging 35% within prime accommodation, up from 31% a year ago. This has resulted in a fall to the average gross effective rent of 5.4% over the past year, to sit at $449/m². Effective rents are expected to remain stable for the remainder of 2014 with marginal improvement emerging early 2015, with 2.3% p.a growth forecast to July 2015. Owners will then attempt to maintain these gains during 2016.

> "Push back on prime face rents has continued to build; however owners have surrendered further to incentives"

Average gross secondary face rents are currently $537/m² which represents an increase from one year ago. However as the secondary market struggles with record high vacancy levels, incentives have continued to increase, currently averaging 37% for secondary accommodation – up from 32% a year ago. Overall the secondary effective rent has softened a further 4.3% over the 12 months to July 2014 to average $338/m² gross. Going forward, secondary rents are expected to plateau with little to no improvement expected until the second half of 2015 at the earliest.

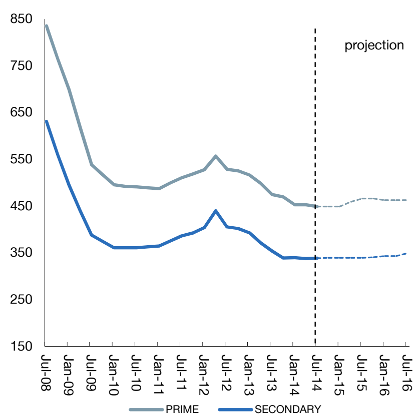
TABLE 3
Recent Leasing Activity Brisbane CBD

Address	NLA m²	Face Rent $/m²	Term yrs	Incentive (%)`	Tenant	Start Date
480 Queen St	5,000	undis	undis	undis	HWL Ebsworth^	2016
480 Queen St	6,900	undis	10	undis	PwC^	2016
480 Queen St	4,000	undis	8	undis	Allens Linklaters^	2016
1 Eagle St	1,200	790 g	10	30-35	St George Bank	Oct 15
192 Ann St	6,300	595 g	10	undis	UnitingCare	Jun 15
295 Ann St	2,422	undis	5	undis	RungePincockMinaro#	Jun 15
123 Albert St	7,500	c350 g	7	Nil	Suncorp#	Feb 15
12 Creek St	1,700	700 g	10	30-35	AFSA	Jan 15
400 George St	1,423	710 g	4.5	35+	Fair Work Ombudsman#	Nov 14
145 Ann St	2,210	675 g	10	25-30	QBE	Mar 14

`estimated incentive calculated on a straight line basis g gross ^ pre-commitment # sub-lease

Source: Knight Frank

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



Source: Knight Frank

INVESTMENT ACTIVITY & YIELDS

The investment market has been on an upswing during 2013 and 2014 to date, with Brisbane sharing in the high demand for investments nationally. Total transaction activity in the Brisbane CBD for 2013/14 FY was $1.178 billion, the second highest result since 2007. However this was behind the $2.034 billion recorded in 2012/13 which was boosted by the State Govt Portfolio and the 480 Queen Street pre-sale which accounted for $958 million. Despite the continued high demand for prime product, there has been relatively fewer transactions when compared with Sydney and Melbourne. In part this has been due to a lack of prime properties available for sale, but also the residential conversion trend, which is active in the southern cities, is not yet widespread in Brisbane's secondary market although it is expected to in due course.

Following the strong end to 2013 with the sales of a 50% interest in 1 William Street ($400 million), 179 Turbot Street ($172.3 million) and 307 Queen Street ($120.8 million) significant transactions in 2014 have been less frequent.

To date in 2014 there has been just under $500 million in sales activity over five sales. The three largest being 70 Eagle Street ($122.7 million), 60 Albert Street ($161.3 million) and 50 Ann Street ($131.8 million).

The recent sale of 70 Eagle Street has demonstrated the demand for prime assets, with the US based purchaser, Pembroke Real Estate, paying $122.7 million for the 11,476m² asset at a core market yield of circa 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.

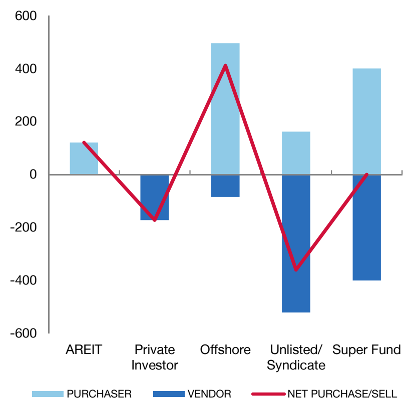
Another relatively recent major sale was the DEXUS Wholesale Fund's purchase of 60 Albert Street for $161.3 million. With a shorter WALE and significant sub-lease space available within the building, despite its modern prime characteristics, it was relatively harshly analysed by the market, reflecting a core market yield of 8.16%. The B Grade 50 Ann Street sold for $131.8 million and despite the strong tenant covenant of being fully leased to the State Government, the downside was limited access to market reviews and a WALE of 6.3 years. The purchase by CIMB reflected a core market yield of 8.67%.

Following the sale of 80 Albert Street for conversion to a hotel in mid-2013 the recent sale of 171 George Street is the second sale of a major CBD asset to be repurposed. The heritage style building was sold for $35 million ($4,023/m²) and will be converted into hotel accommodation by Toga Hotels.

FIGURE 5

Brisbane CBD Purchaser/Vendor

$ million sales ($10 million+) 2013/14 FY



Source: Knight Frank

During 2013/2014 purchasing activity has been dominated by offshore funds with 42% of transactions by value, followed by Super Funds (34%). After a strong 2013 AREITs have been relatively quiet with GDI Property Group's purchase of 307 Queen Street in late 2013 the only major activity. Unlisted funds and syndicates were the strongest net sellers of assets over the 12 month period with only one acquisition and seven disposals.

TABLE 4

Recent Sales Activity Brisbane CBD

Address	Grade	Price $ mil	Core Market Yield %	NLA m²	$/m² NLA	WALE	Vendor	Purchaser	Sale Date
443 Queen St	B	49.00	6.25^	5,500	8,909	c1.9	Private Investor	Cbus Property	Aug 14
50 Ann St	B	131.80	8.67	25,519	5,165	6.3	Private Investor	CIMB TrustCapital	Aug 14
171 George St*	B	35.00	VP	8,700	4,023	n/a	Private Investor	Toga Hotels Australia	Jul 14
70 Eagle St	A	122.70	6.25	11,476	10,692	8.4	APPF Commercial & ADIA	Pembroke Real Estate	Apr 14
60 Albert St	B	161.30	8.16	21,263	7,586	4.6	La Salle Investment Management	DEXUS Wholesale Property Fund	Jan 14
1 William St	A	400.00#	6.50#	76,853	10,409	15.0	Cbus Property	ISPT	Dec 13

^ passing yield *purchased for conversion/expansion to hotel use #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

Source: Knight Frank

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 nine months.

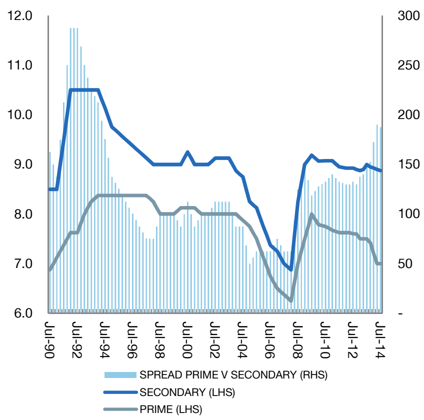
Average prime yields are currently 6.25% - 7.75% with a median of 7.0%, which represents firming of 50 basis points over the past year. Much of this firming has come from reductions at the lower end of the yield range, with the upper range having moved relatively less, reflecting the leasing risk embodied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

There remains scope for some further demand led firming at the lower yield range, but only for a select cohort of assets which embody purely core characteristics. In contrast the upper yield range is expected to remain more sticky, reliant on an improvement in the leasing outlook for any major firming where income support is not comprehensive.

Secondary yields have firmed only marginally over the past six months as the leasing conditions remained soft. Secondary yields currently range between 8.15% and 9.60%, with an average of 8.88%. Although the interest in recycling CBD buildings is increasing, without competition between residential developers supporting prices, as with the southern states, the yields for secondary assets have not been tested. This is expected to change in coming months as the firming trend from the prime market flows through. To date this impact has been moderated by the relatively difficult leasing conditions in the secondary market and income support is a requirement for most purchasers.

Buildings currently on the market include the landmark premium building, Waterfront Place (1 Eagle Street) which is expected to demonstrate the continued strength of prime yields, particularly for an established asset. Additional activity in the secondary market is expected with purchasers continuing to look further up the yield curve for secondary or development assets, however some short -term income support is still required in most cases.

FIGURE 6
Brisbane CBD Core Market Yields
% Yield LHS & Basis Points RHS



Source: Knight Frank

Waterfront Place, a 59,000m² premium building, is currently offered for sale and is expected to show considerable yield compression from when Future Fund purchased 50% in 2011 for a core market yield of 7.88%

Outlook

- Improved tenant 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 stabilised.
- Vacancy is expected to show some improvement in early 2015 until the commencement of the next supply cycle from late 2015 and into 2016.
- Following the 180,000m² of stock additions from projects currently under construction the longer term supply pipeline is leaner with many projects converting to residential or hotel.
- The new supply, particularly 1 William Street which will draw State Government workers from older accommodation, will trigger an unprecedented withdrawal of older stock in the Brisbane market.
- The current weakness in the secondary market is also causing an increased interest from developers on converting some of this vacant stock to either hotel or residential uses which has the potential to benefit the vacancy rate. With two sales for this purpose to date this is expected to grow, but not reach the extent of the southern states.
- Prime yields have shown sustained firming over the past year as the demand from local and offshore investors has grown. With offshore buyers dominant over the past year prime opportunities will continue to be highly sought by a diverse purchaser group, placing continued pressure on yields at the lower range.

RESEARCH
Jennelle Wilson
Director—Research QLD
+61 7 3246 8830
Jennelle.wilson@au.knightfrank.com

Matt Whitby
National Director—Head of Research & Consulting
+61 2 9036 6616
Matt.Whitby@au.knightfrank.com

QUEENSLAND
Grant Whittaker
Managing Director - QLD
+61 7 3246 8888
Grant.Whittaker@au.knightfrank.com

CAPITAL TRANSACTIONS
Justin Bond
Senior Director—Capital Markets
+61 7 3246 8872
Justin.Bond@au.knightfrank.com

Ben McGrath
Senior Director—Capital Markets
+61 7 3246 8814
Ben.McGrath@au.knightfrank.com

Neil Brookes
Head of Capital Markets—APAC
+65 8309 4985
Neil.Brookes@asia.knightfrank.com

COMMERCIAL SALES
Richard Morrison
Director—Commercial Sales
+61 7 3246 8846
Richard.Morrison@au.knightfrank.com

COMMERCIAL LEASING
David Howson
Director—Office Leasing
+61 7 3246 8833
David.Howson@au.knightfrank.com

Campbell Tait
Director—Office Leasing
+61 7 3246 8868
Campbell.Tait@au.knightfrank.com

VALUATIONS
Peter Zischke
Director
+61 7 3246 8811
Peter.Zischke@qld.knightfrankval.com.au

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